No. 87-1097-CFX
Status: GRANTED

Title: Otis R. Bowen, Secretary of Health and Human Services, Petitioner
v.
Georgetown University Hospital, et al.

Docketed:
December 30, 1987

Court: United States Court of Appeals for the District of Columbia Circuit

Counsel for petitioner: Solicitor General

Counsel for respondent: Sutter,Ronald N.

NOTE: Ext. of time filed 11/23/87 granted to & incl. 12/30/87 by C.J., cited

Entry	Date	Note	Proceedings and Orders
1	Nov 19 1987		Application for extension of time to file petition and order granting same until December 30, 1987 (Chief Justice, November 23, 1987).
2	Dec 30 1987	G	Petition for writ of certiorari filed.
3	Feb 3 1988		DISTRIBUTED. February 19, 1988
4	Feb 3 1988	X	Brief of respondent Georgetown University Hospital in opposition filed.
5	Feb 12 1988	X	Reply brief of petitioner Bowen, Sec. H&HS filed.
7	Feb 22 1988		REDISTRIBUTED. February 26, 1988
8	Feb 29 1988		Petition GRANTED.
			**********
10	Apr 11 1988		Order extending time to file brief of petitioner on the merits until April 30, 1988.
11	Apr 30 1988		Joint appendix filed.
12	Apr 30 1988		Brief of petitioner Bowen, Sec. H&HS filed.
14	May 10 1988		Order extending time to file brief of respondent on the merits until June 27, 1988.
15	Jun 24 1988		Brief amici curiae of Sisters of Mercy Health Corp., et al. filed.
16	Jun 27 1988		Brief of respondent Georgetown University Hospital filed.
17	Jun 27 1988		Brief amicus curiae of American Hospital Association filed.
18	Jul 6 1988		CIRCULATED.
19	Jul 15 1988		Set for argument. Tuesday, October 11, 1988. (1st case) (1 hr.)
20	Jul 20 1988		Record filed.
		*	Certified original record received.
21	Jul 27 1988	X	Reply brief of petitioner Bowen, Sec. H&HS filed.
22	Aug 4 1988	D	Motion of Ohio Power Company for leave to file a brief as amicus curiae, out-of-time, filed.
23	Sep 7 1988	X	Supplemental brief of petitioner Bowen, Sec. H&HS filed.
24	Oct 3 1988		Motion of Ohio Power Company for leave to file a brief as amicus curiae, out-of-time, DENIED.
25	Oct 5 1988	X	Supplemental brief of respondents Georgetown University Hospital filed.
26	Oct 11 1988		ARGUED.

87 1097

No.

In the Supreme Court of the United States

OCTOBER TERM, 1987

OTIS R. BOWEN, SECRETARY OF HEALTH AND HUMAN SERVICES, PETITIONER

v.

GEORGETOWN UNIVERSITY HOSPITAL, ET AL.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE DISTRICT OF COLUMBIA CIRCUIT

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QUESTIONS PRESENTED

1. Whether Section 1861(v)(1)(A)(ii) of the Medicare Act, 42 U.S.C. (Supp. III) 1395x(v)(1)(A)(ii), which allows the Secretary of Health and Human Services to promulgate "regulations * * * for the making of suitable retroactive corrective adjustments where, for a provider of services for any fiscal period, the aggregate reimbursement produced by the methods of determining costs proves to be either inadequate or excessive," authorizes the Secretary to promulgate a retroactive regulation establishing a ceiling on reimbursement for hospitals' wage costs, and to apply that regulation in reimbursement proceedings not final at the time that the regulation was promulgated.

2. Whether the Administrative Procedure Act (APA), 5 U.S.C. (& Supp. IV) 551 *et seq.*, prohibits an agency from promulgating retroactive regulations even if the decision to apply a regulation retroactively is not arbitrary, capricious, an abuse of discretion, or otherwise contrary to law.

PARTIES TO THE PROCEEDING

In addition to the parties named in the caption, Howard University as Howard University Hospital, Tuscon Hospital Liquidating Corp. (formerly Tuscon General Hospital), Greater Southeast Community Hospital, Tuscon Medical Center, St. Cloud Hospital, and Community Hospital of Battle Creek were plaintiffs in actions in the district court. These parties also were appellees in the court of appeals.

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In the Supreme Court of the United States

OCTOBER TERM, 1987

No.

OTIS R. BOWEN, SECRETARY OF HEALTH AND HUMAN SERVICES, PETITIONER

v.

GEORGETOWN UNIVERSITY HOSPITAL, ET AL.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE DISTRICT OF COLUMBIA CIRCUIT

The Solicitor General, on behalf of the Secretary of Health and Human Services, petitions for a writ of certiorari to review the judgment of the United States Court of Appeals for the District of Columbia Circuit in this case.

OPINIONS BELOW

The opinion of the court of appeals (App., *infra,* 1a-19a) is reported at 821 F.2d 750. The opinion and order of the district court (App., *infra,* 20a-42a) are unreported.

JURISDICTION

The judgment of the court of appeals (App., *infra,* 43a-44a) was entered on June 26, 1987, and a petition for rehearing was denied on September 1, 1987 (App., *infra,* 45a-46a). On November 23, 1987, the Chief Justice entered an order extending the time for filing a petition for

a writ of certiorari to and including December 30, 1987. The jurisdiction of this Court rests upon 28 U.S.C. 1254(1).

STATUTES INVOLVED

5 U.S.C. 551(4) provides in pertinent part:

For the purpose of this subchapter –

* * * * *

(4) "rule" means the whole or a part of an agency statement of general or particular applicability and future effect designed to implement, interpret, or prescribe law or policy or describing the organization, procedure, or practice requirements of an agency * * *.

42 U.S.C. (Supp. III). 1395x(v)(1)(A) provides in pertinent part:

The reasonable cost of any services shall be the cost actually incurred, excluding therefrom any part of incurred cost found to be unnecessary in the efficient delivery of needed health services, and shall be determined in accordance with regulations establishing the method or methods to be used, and the items to be included, in determining such costs for various types or classes of institutions, agencies, and services; * * *. Such regulations shall * * * (ii) provide for the making of suitable retroactive corrective adjustments where, for a provider of services for any fiscal period, the aggregate reimbursement produced by the methods of determining costs proves to be either inadequate or excessive.

STATEMENT

1. At the time of the events at issue in this case, all "providers" of health care services to Medicare beneficiaries were reimbursed by the Secretary of Health and Human Services on an annual basis for the "reasonable cost" of those health care services. 42 U.S.C. (& Supp. III) 1395f(b), 1395x(u) and (v)(1)(A).[1] Congress expressly authorized the Secretary to promulgate regulations "establishing the method or methods to be used, and the items to be included, in determining" reasonable costs (42 U.S.C. (Supp. III) 1395x(v)(1)(A)). Alarmed by dramatic increases in the cost of hospital care, Congress in 1972 authorized the Secretary to "establish[ ] * * * limits on the * * * costs * * * to be recognized as reasonable" (42 U.S.C. (Supp. III) 1395x(v)(1)(A)). Thus, "based on estimates of the costs necessary in the efficient delivery of needed health services," the Secretary may by regulation limit both the types and amounts of costs that are reimbursable under the Medicare program (42 U.S.C. (Supp. III) 1395x(v)(1)(A)).

[1] A provider was reimbursed for its "customary charges" if those charges were less than the reasonable cost. 42 U.S.C. 1395f(b)(1).

Most hospitals are no longer reimbursed for inpatient services to Medicare beneficiaries solely on the basis of the "reasonable cost" incurred in providing services to Medicare patients. In Title VI of the Social Security Amendments of 1983, Pub. L. No. 98-21, §§ 601-607, 97 Stat. 149-172, Congress adopted the prospective payment system (PPS). Under PPS (which has been implemented over a four-year transition period beginning on October 1, 1983), hospitals are paid predetermined rates for specific services, which rates are not tied to specific costs incurred by the hospital in providing those services. See 42 U.S.C. (Supp. III) 1395ww(d), as amended by the Consolidated Omnibus Budget Reconciliation Act of 1985, Pub. L. No. 99-272, § 9102, 100 Stat. 155. Congress adopted PPS primarily "to reform the financial incentives hospitals face, promoting efficiency in the provision of services by rewarding cost/effective hospital practices" (H.R. Rep. 98-25, 98th Cong., 1st Sess. Pt. 1, at 132 (1983)). Many Medicare providers are not covered by the prospective payment system, however, and continue to obtain reimbursement for their "reasonable" costs. See pages 23-24, *infra*.

In 1979, the Secretary exercised his authority to establish cost limits by promulgating a regulation that prescribed ceilings upon Medicare reimbursement for hospitals' inpatient general routine operating costs. See 44 Fed. Reg. 31806 (1979). The regulation divided these costs into two categories: wage costs and all other costs. It fixed maximum reimbursable non-wage costs on a nationwide basis for various categories of hospitals; the rule also set nationwide wage cost ceilings, but made those cost limits subject to adjustment on a hospital-by-hospital basis to account for variations in wage rates over different geographic areas. The adjustment was made by applying to the nationwide wage cost ceilings an index derived from Bureau of Labor Statistics data for hospital wages in the particular geographic area. A particular hospital's wage cost ceiling was thus dependent upon the index number for that hospital's geographic area. *Id.* at 31807-31808.[2] The wage indices for each geographic area for hospital cost reporting periods beginning on or after July 1, 1979, were set forth in the regulation (*id.* at 31812-31813);[3] the 1980 indices were published one year later (45 Fed. Reg. 41868, 41875-41876 (1980)).

In 1981, the Secretary adjusted the formula used to calculate the wage indices by excluding data concerning

[2] As the court of appeals explained, "[t]he wage index for an individual hospital was to be calculated by dividing the 'local' average hospital wage by the 'national' average hospital wage"; "[i]f the hospital was located within a Standard Metropolitan Statistical Area ('SMSA'), the appropriate 'local' figure would be the average hospital wage within that SMSA, and the appropriate 'national' figure would be the average hospital wage among all SMSAs. If the hospital was located outside of a SMSA, the appropriate 'local' and 'national' figures would be calculated using non-SMSA wage data" (App., *infra,* 8a & n.9).

[3] The Secretary subsequently revised the cost limits for this period (see 44 Fed. Reg. 46949 (1979)).

the wages paid by hospitals owned by the federal government. See 46 Fed. Reg. 33638-33639 (1981). The Secretary explained that "[b]ecause these hospitals typically use national pay scales, the amounts they pay their employees do not necessarily reflect area wage levels. We believe excluding data from these hospitals will help improve the accuracy of the wage index adjustment" (*id.* at 33639).[4]

The Secretary viewed this refinement in the index methodology as a "minor technical change[ ]" (46 Fed. Reg. 33638 (1981)). He accordingly did not provide notice or an opportunity to comment before placing the revised index formula into effect. The Secretary further found that the public interest required that the new wage indices be placed into effect immediately: "the current [1980] limits would [otherwise] remain in effect without adjustment for cost reporting periods beginning after June 30, [1981] since there is no provision in the current schedule for adjusting the limits for cost reporting periods that begin after the date" (*id.* at 33640).

Several hospitals sought judicial review of the Secretary's action in the United States District Court for the District of Columbia, claiming that the Secretary had violated the Administrative Procedure Act, 5 U.S.C. (& Supp. IV) 551 *et seq.*, by failing to provide notice and an opportunity to comment before altering the wage index methodology. The court concluded that "the Secretary's decision to exempt the [decision to alter the index methodology] from notice and comment must be declared unlawful" (App., *infra,* 60a). Citing the provisions of the Medicare Act limiting the availability of judical review,

[4] The Secretary also used approximate, rather than actual index values for 26 geographic areas because the Bureau of Labor Statistics could not supply actual data for those areas (46 Fed. Reg. 33638-33639 (1981)).

the district court declined to issue an injunction barring the application of the 1981 wage indices to the plaintiffs' reimbursement claims. It instead issued an order declaring that the revised wage indices were "invalid" (App., *infra,* 66a).

In February 1984, the Secretary issued a notice of proposed rulemaking proposing the reissuance of the 1981 wage indices. See 49 Fed. Reg. 6175 (1984). The notice stated that the indices set forth in the proposed rule would apply to cost reporting periods beginning on or after July 1, 1981 and ending after September 30, 1981, but would not apply to reporting periods beginning on or after October 1, 1982 (*ibid.*).[5] Thus, "the rule was to apply to cost accounting periods that would have been covered prospectively by the Secretary's 1981 rule had that rule been promulgated in accordance with the procedural requirements of the APA" (App., *infra,* 9a).

The Secretary stated (49 Fed. Reg. 6177 (1984)) that

> the exclusion of Federal government hospital data would improve the accuracy of the wage index because most Federal hospitals characteristically employ physicians and other high salaried professionals whose salaries are based on national rather than local wage scales. This factor tends to overstate the average hospital wage in areas with Federal institutions as compared to areas without such Federal facilities. Since the purpose of the wage index is to reflect area-by-area differences in the labor-related component of hospital costs, the exclusion of Federal hospital data better enables the wage index to accurately reflect area-by-area labor-related costs.

The Secretary observed that where non-federal hospitals pay wages similar to those paid by the federal government,

[5] Reimbursement of routine inpatient costs for those later cost periods is governed by different rules. See 49 Fed. Reg. 6175 (1984).

the data from non-federal hospitals would reflect those wages, and "the exclusion of Federal wages would have little effect on the wage index" (*ibid.*). If, on the other hand, "wages paid to Federal hospital employees are higher than most area hospital wage levels, then the inclusion of Federal data results in most hospitals receiving a higher Medicare cost limit than is warranted based on their expected costs. Such a result defeats the purpose of the cost limits, which is to limit a provider's reimbursement to only those costs necessary in the efficient delivery of needed health services" (*ibid.*).

The Secretary stated that the reissuance of the 1981 wage indices, which had been calculated without wage data from federally-owned hospitals, "avoids placing an unwarranted hardship and burden on intermediaries and many hospitals, while it would impose only a minimal burden on a few hospitals" (49 Fed. Reg. 6177 (1984)). Because "[t]he inclusion of Federal data in the wage index at this point in time would result in overpayments to many hospitals," intermediaries might be forced to review already-settled cost reports and hospitals that had received excess reimbursement would be required to repay these sums to the government (*ibid.*). "In contrast, those few hospitals that would receive less reimbursement if Federal hospital data are excluded from the wage index would not be unduly harmed or burdened by the reissuance of the wage index," because those hospitals could only have relied on the wage indices published in 1981 (*ibid.*). "Since these limits are prospectively established and published in advance, all hospitals knew before the beginning of their respective cost reporting periods what their cost limit would be. * * * This proposed notice would simply put the previously set cost limits back into effect" (*ibid.*).

After considering comments submitted by interested parties, the Secretary reaffirmed the propriety of the change in index methodology and reissued the 1981 wage

indices in final form (49 Fed. Reg. 46495 (1984)). She rejected the contention that the application of the 1984 rule to 1981 cost years constituted an impermissible retroactive rule, observing that "as a practical matter hospitals could only have relied on the [1981] rule in determining their respective cost limits" for the cost periods that would be covered by the 1984 rule (*id.* at 46497). Because "[e]ach hospital [therefore] knew in advance of its cost reporting period what its cost limit would be for this period," the Secretary concluded that the 1984 rule could properly be applied to 1981 cost reporting periods (*ibid.*).

2. Respondents are health care providers that operate hospitals. Respondents' fiscal intermediaries applied the 1984 wage indices to recoup funds previously reimbursed to respondents under wage indices that included federal hospital wage data. Respondents obtained the necessary certification from the Provider Reimbursement Review Board and commenced several actions in the United States District Court for the District of Columbia challenging the Secretary's decision to apply the revised index calculation methodology to their 1981 cost periods (see 42 U.S.C. (Supp. III) 1395*oo*(f)(1)). The district court consolidated the actions and entered judgment in favor of respondents. The court declined to address respondents' claims that the Secretary lacked the statutory authority to issue retroactive rules. Instead, the court held that the decision to apply the 1981 wage indices retroactively was invalid on the facts of this case. See App., *infra,* 20a-42a.

In so ruling, the district court applied the five-factor balancing test set forth in *Retail, Wholesale & Dep't Store Union* v. *NLRB,* 466 F.2d 380, 388 (D.C. Cir. 1972), to determine whether the rule could properly be given retroactive effect. The court concluded (App., *infra,* 38a) that "the balancing of factors in this case compels the conclusion that Medicare statute interests are only minimally served, if at all, by the Secretary's retroactive application

of his reissued wage index to recoup funds from these plaintiffs. In contrast, the ill effects of the Secretary's actions are substantial for these plaintiffs and for the general integrity of the administrative rule-making process. Accordingly, retroactive application against these plaintiffs must be denied."

3. The court of appeals affirmed, but rested its decision upon grounds different from those adopted by the district court (App., *infra,* 1a-19a). The court acknowledged that adjudicatory orders issued by administrative agencies may be given retroactive effect. But, citing the Administrative Procedure Act's definition of a "rule" as "an agency statement of general or particular applicability and *future effect*" (5 U.S.C. 551(4) (emphasis added)), the court concluded that "the APA requires that legislative rules be given future effect only. Because of this clear statutory command, equitable considerations are irrelevant to the determination of whether the Secretary's rule may be applied retroactively; such retroactive application is foreclosed by the express terms of the APA" (App., *infra,* 11a-12a, 13a).

The court stated that when the district court invalidated the 1981 rule, "it necessarily reinstated the Secretary's *1979* rule, which required the Secretary to reimburse providers using a formula that included federal-hospital data" (App., *infra,* 13a (emphasis in original)). "The Secretary's 1984 rule obviously can have no application to cost accounting periods that were, by virtue of the District Court's ruling, governed by the Secretary's 1979 rule" (*ibid.*). In the Court's view, "agencies would be free to violate the rulemaking requirements of the APA with impunity if, upon invalidation of a rule, they were free to reissue that rule on a retroactive basis" (*id.* at 14a). The court acknowledged that if an agency rule is invalidated on procedural grounds, "the agency must, of course, be given an opportunity to correct the procedural defect and prom-

ulgate a new rule"; but "the corrected rule, like all other legislative rules, [must] be prospective in effect only" (*ibid.*).[6]

The court of appeals stated that Congress may "override the general terms of the APA by explicitly authorizing retroactive regulations in an agency's organic statute" (App., *infra,* 14a). Petitioner contended that the retroactive 1984 regulation was specifically authorized by Section 1861(v)(1)(A)(ii) of the Medicare Act, 42 U.S.C. (Supp. III) 1395x(v)(1)(A)(ii), which empowers the Secretary of Health and Human Services to issue "regulations" that "provide for the making of suitable retroactive corrective adjustments where * * * the aggregate reimbursement produced by the methods of determining costs proves to be either inadequate or excessive." The court of appeals rejected that argument, however, holding that "Congress did *not* intend to empower the Secretary to promulgate retroactive cost-limit rules" (App., *infra,* 15a (emphasis in original)). As an initial matter, the court stated that "[i]t was not until the litigation in the district court that the Secretary sought to invoke the retroactive adjustments provision as authority for the rule" (App., *infra,* 16a). Because the provision was not explicitly cited when the 1984 rule was promulgated, the court thought that it could not be invoked to justify that rule.

With respect to the merits of this argument, the court of appeals discerned "a critical distinction between the power to promulgate retroactive rules of general application and the power to make retroactive corrective adjustments in

[6] In its order denying the petition for rehearing, the court of appeals stated that "[a]s a general rule, the APA requires that legislative rules be given future effect only. Whatever exceptions might exist to this general rule were not implicated in the case before us. Our opinion therefore does not purport to address circumstances in which there may be an exception to the rule against retroactive rulemaking" (App., *infra,* 45a).

the reimbursements of particular providers whose aggregate reimbursement is shown to be either 'inadequate or excessive' " in case-by-case evidentiary proceedings (App., *infra,* 17a). It concluded that Section 1861(v)(1)(A)(ii) confers only the latter power upon the Secretary, authorizing him to make retroactive adjustments to individual reimbursement determinations where he is able to "prove that inadequate or excessive reimbursements to a provider have resulted from his 'methods of determining costs' " (App., *infra,* 18a (citation omitted)). In the absence of individualized proof that the reimbursement awarded respondents exceeded their reasonable costs, the court held that the Secretary had no authority to adjust those reimbursement awards retroactively (*id.* at 18a-19a).

REASONS FOR GRANTING THE PETITION

This case concerns an issue of considerable importance to the administration of the Medicare program—whether the Secretary of Health and Human Services may give retroactive effect to regulations setting the amount of reimbursement that may be paid to providers of health services to Medicare beneficiaries. It is important to note at the outset that, while the rule at issue in this case does operate retroactively in the technical sense that it governs reimbursement for costs incurred by respondents prior to the date upon which the rule was promulgated, that retroactive effect has none of the qualities that have led the courts to take a cautious view of the retroactive application of legal standards. The wage indices at issue here were initially promulgated as an entirely prospective regulation issued in 1981. When that regulation was invalidated by the district court on procedural grounds in 1983, the Secretary decided not to appeal that determination; instead—after subjecting the regulation to prior notice and com-

ment—she reissued the regulation in 1984 and gave the revalidated regulation the same 1981 effective date as the original regulation. Because the identical substantive standard had been adopted in 1981, all hospitals affected by the 1984 rule—including respondents—were plainly on notice *before they incurred the costs subject to the 1984 rule* that the reasonableness of those costs would be measured against the standard contained in that rule.

Despite the fact that respondents can therefore demonstrate no prejudice of any kind from the Secretary's decision to give retroactive effect to the reissued rule, the court of appeals held that both the Medicare Act and the Administrative Procedure Act barred the Secretary from applying the rule on a retroactive basis. In reaching that result, the court of appeals adopted constructions of these statutes that squarely conflict with the decisions of numerous other courts of appeals. With respect to the Medicare Act, the court's determination cannot be reconciled with the express statutory language authorizing retroactive administrative action. And the court's unprecedented interpretation of the Administrative Procedure Act, precluding federal administrative agencies from engaging in virtually any retroactive rulemaking, is similarly at odds with that statute's language and legislative history.

The scope of the Secretary's authority to give retroactive effect to rules governing Medicare cost reimbursement is a matter of considerable practical importance. In carrying out his statutory mandate to ensure that reimbursement neither exceeds nor falls short of a provider's reasonable costs, the Secretary may learn that a prior cost reimbursement methodology was flawed—either in favor of providers or to their detriment—and conclude that retroactive adjustment of reimbursement awards is therefore appropriate. By prohibiting the Secretary from making such adjustments through rules of general application, and requiring the Secretary to engage in a separate adjudi-

cation for each individual provider (in which it would be necessary to prove both the flaws in the old reimbursement methodology and the propriety of the new standard) the decision of the court below would effectively eliminate the only realistic method available to the Secretary to make retroactive corrections to reimbursement decisions. Moreover, the effect of the court's erroneous construction of the Administrative Procedure Act is not confined to the Medicare context; it dramatically reduces the rulemaking authority of all federal agencies, barring retroactive rulemaking in essentially all circumstances regardless of the balance between the public interest and any prejudice to the affected parties. For all of these reasons, review by this Court is plainly warranted.[7]

1. a. Section 1861(v)(1)(A)(ii) of the Medicare Act, 42 U.S.C. (Supp. III) 1395x(v)(1)(A)(ii), empowers the Secretary of Health and Human Services to issue regulations that "provide for the making of suitable retroactive corrective adjustments where * * * the aggregate reimbursement produced by the methods of determining costs proves to be either inadequate or excessive." There is a considerable disagreement among the courts of appeals regarding the scope of the Secretary's authority under this provision. Some court of appeals have concluded that "[u]pon determining that one of his cost reimbursement regulations produces inadequate or excessive payments to providers, the Secretary has a statutory duty [under Section 1861(v)(1)(A)(ii)] to make suitable retroactive corrective adjustments" through the issuance of regulations (*Springdale Convalescent Center* v. *Mathews*, 545 F.2d 943, 954 (5th Cir. 1977)). These courts have held that the

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[7] This case does not raise the jurisdictional problem presented in *Bowen* v. *Commonwealth of Massachusetts*, petition for cert. pending, No. 87-712, because the applicable waiver of sovereign immunity is contained in 42 U.S.C. (& Supp. III) 1395*oo*(f), not the Administrative Procedure Act or the Tucker Act.

Secretary may—and in some circumstances must—apply revised cost reimbursement regulations retroactively where the prior rule resulted in an improper level of reimbursement. *Ibid.*; see also *Regents of the University of California* v. *Heckler*, 771 F.2d 1182, 1188-1189 (9th Cir. 1985); *Fairfax Nursing Center, Inc.* v. *Califano*, 590 F.2d 1297, 1300 (4th Cir. 1979); *Hazelwood Chronic & Convalescent Hospital, Inc.* v. *Weinberger*, 543 F.2d 703, 707-708 (9th Cir. 1976), vacated on other grounds, 430 U.S. 952 (1977); *Whitecliff, Inc.* v. *United States*, 536 F.2d 347, 352 (Ct. Cl. 1976), cert. denied, 430 U.S. 969 (1977); *Kingsbrook Jewish Medical Center* v. *Richardson*, 486 F.2d 663, 669-670 (2d Cir. 1973); cf. *Tallahassee Memorial Regional Medical Center* v. *Bowen*, 815 F.2d 1435, 1453-1454 & n.36 (11th Cir. 1987), petition for cert. pending, No. 87-380 (applying balancing test to determine whether rule may be applied retroactively); *Mason General Hospital* v. *Secretary of Health & Human Services*, 809 F.2d 1220, 1225-1226 (6th Cir. 1987) (same).

The court below took a narrower view of Section 1861(v)(1)(A)(ii), holding that the provision does not empower the Secretary to issue retroactive rules, but only authorizes retroactive adjustment of reimbursement awards on a case-by-case basis upon proof that a particular reimbursement award was either inadequate or excessive. App., *infra*, 16a-19a; see also *St. Paul-Ramsey Medical Center* v. *Bowen*, 816 F.2d 417, 419-420 (8th Cir. 1987) (holding that the Secretary has a duty to make retroactive adjustments without stating whether such adjustments may be made by regulation). A third group of courts has stated that the provision does not permit any retroactive reassessment of reimbursement decisions, but only directs the Secretary "to promulgate regulations that mandate retroactive adjustments in the *payments* received by providers, so as to bring the amounts paid to them on the basis of their monthly estimates in line with the amount actually due them under the annual audit."

Daughters of Miriam Center for the Aged v. *Mathews*, 590 F.2d 1250, 1258 n.23 (3d Cir. 1978) (emphasis in original); see also *Adams Nursing Home of Williamstown, Inc.* v. *Mathews*, 548 F.2d 1077, 1082 (1st Cir. 1977). On this view of Section 1861(v)(1)(A)(ii), the provision simply requires the Secretary to establish a mechanism for reconciling the Secretary's advance estimated payments with the amount finally determined to be due the provider following review of the provider's annual cost report.[8]

b. Section 1861(v)(1)(A)(ii) expressly authorizes the Secretary to issue regulations that "provide for the making of suitable retroactive corrective adjustments" in reimbursement awards. Where, as here, the Secretary concludes that application of a cost reimbursement regulation has resulted in either an excessive or inadequate reimbursement award, the statute by its plain language permits the Secretary to issue a retroactive regulation to adjust the erroneous reimbursement determination as long as that course of action is reasonable. Nothing in the language of the statute supports the court of appeals' conclusion that the Secretary may retroactively reexamine reimbursement decisions on a case-by-case basis, but may not issue retroactive rules of general application; the statute expressly authorizes the issuance of *regulations* providing for retroactive readjustments in reimbursement determinations.[9]

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[8] Indeed, the courts of appeals have themselves recognized the existence of a conflict regarding the proper interpretation of Section 1861(v)(1)(A)(ii). *Tallahassee Memorial Regional Medical Center* v. *Bowen*, 815 F.2d at 1454 n.36; *Daughters of Miriam Center for the Aged* v. *Mathews*, 590 F.2d at 1258-1259 n.23; App., *infra*, 16a (footnote omitted) (court below observed that its "sister circuits have struggled to define the precise contours of the retroactive corrective adjustments provision"); see also *id.* at 34a (district court opinion).

[9] The court of appeals stated that the Secretary could not rely upon Section 1861(v)(1)(A)(ii) because "[i]t was not until the litigation

Not only is the court of appeals' interpretation at odds with the language of the statute, it is wholly unrealistic. It would permit retroactive adjustments to reimbursement determinations identical to that achieved by the 1984 rule, but only if the Secretary makes those adjustments in separate, individualized proceedings for each provider. In view of the vast scope of the Medicare program, that approach is simply unworkable. See *City of Austin* v. *Heckler*, 753 F.2d 1307, 1317 (5th Cir. 1985) ("regulation [of Medicare reimbursement] cannot be accomplished on a hospital-by-hospital basis"). If, as the court appears to agree, retroactive adjustments are permissible, then the Secretary must have the authority to make those adjustments in an administratively practicable manner. Because the Secretary can utilize regulations to set cost limits as an initial manner, it makes no sense to bar the Secretary from using regulations to adjust reimbursement awards retroactively.

The court of appeals rested its construction of the statute in part upon the legislative history of the 1972

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in the District Court that the Secretary sought to invoke the retroactive corrective adjustments provision as authority for the rule" (App., *infra*, 16a). But the Secretary did expressly invoke Section 1861(v), 42 U.S.C. (& Supp. III) 1395x(v)—of which Section 1861(v)(1)(A)(ii) is a subsection—as authority for the issuance of the 1984 rule. See 49 Fed. Reg. 6180 (1984); *id.* at 46501. Surely the Secretary is not required to separately list every subsection upon which he specifically relies in promulgating a rule. In any event, this Court has stated that an agency's failure to invoke the proper statutory authority for administrative action does not invalidate that action where the "mistake of the administrative body is one that clearly had no bearing on the procedure used or the substance of the decision reached." *Massachusetts Trustees* v. *United States*, 377 U.S. 235, 247-248 (1964); see also *NLRB* v. *Wyman-Gordon, Co.*, 394 U.S. 759, 767 n.6 (1969); *People of Illinois* v. *ICC*, 722 F.2d 1341, 1348-1349 (7th Cir. 1983); cf. *Baylor University Medical Center* v. *Heckler*, 758 F.2d 1052, 1060 n.14 (5th Cir. 1985). That principle plainly applies here.

amendment to the Medicare statute that authorized the Secretary to promulgate cost limits such as the regulation at issue here (see page 3, *supra*), citing a statement in the congressional committee reports to the effect that this authority " 'would be exercised on a prospective, rather than retrospective, basis, so that the provider would know in advance the limits to Government recognition of incurred costs and have the opportunity to act to avoid having costs that are not reimbursable' " (App., *infra*, 15a (citations omitted)).

As a threshold matter, we are not certain that this legislative history is relevant in interpreting Section 1861(v)(1)(A)(ii), which was included in the original Medicare statute enacted in 1965, and thus was not enacted as part of the 1972 amendments. Even if the legislative history is relevant, however, it does not change the result here because respondents had ample notice of the very cost limits adopted in 1984 before those limits were placed into effect. As we have discussed (see pages 11-12, *supra*), the substantive standard contained in the 1984 regulation was first issued as a prospective rule in 1981. Indeed, that 1981 rule remained undisturbed for the entire time period affected by the retroactive rule—the cost periods beginning after July 1981 and before October 1982—because the rule was not invalidated by the district court until 1983. Thus, respondents obviously were on notice that the reasonableness of their costs would be assessed against the standard set forth in the 1984 rule.[10]

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[10] The court of appeals suggested (App., *infra*, 12a n.11) that the Secretary's interpretation of the statute is flawed because it would allow the Secretary to make his regulations retroactive for an unlimited period of time. But Section 1861(v)(1)(A)(ii) does not override other provisions of the Medicare Act. Thus, when a reimbursement award is final and no longer subject to reopening (see 42 C.F.R. 405.1885), that award cannot be reconsidered pursuant to a rule issued

2. Even if the Secretary's express authority to alter reimbursement decisions retroactively does not empower the Secretary to issue retroactive rules of the type at issue here, the Secretary's action should be upheld as an exercise of his general rulemaking authority under the Medicare Act (see 42 U.S.C. (& Supp. III) 1395x(v)(1)(A), 1395hh) and the Administrative Procedure Act. The court of appeals' contrary determination—which rests on the novel conclusion that the APA prohibits virtually all retroactive rulemaking—should be reviewed by this Court.[11]

a. The decision of the court of appeals regarding the authority of a federal administrative agency to accord retroactive effect to one of its rules conflicts with the decisions of other courts of appeals with respect to that question. The court below stands alone in holding that, as a general matter, a rule promulgated pursuant to the Administrative Procedure Act may not be given retroactive effect (see App., *infra,* 13a). The other courts of appeals to address the question have stated that an agency's decision to give a rule retroactive effect may be upheld if that decision is found to be reasonable after assessment of the public and private interests affected by the decision to apply the rule retroactively. See, *e.g., Texaco, Inc.* v. *De-*

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under Section 1861(v)(1)(A)(ii). See 51 Fed. Reg. 11188 (1986) (stating that retroactive application of medical malpractice cost standard is limited to cost reports not yet closed and costs reports still subject to reopening).

[11] The court of appeals initially stated that all retroactive rulemaking was prohibited by the APA (see App., *infra,* 13a). In its order denying the petition for rehearing, the court indicated that there might be some exceptions to this "general rule," but declined to state what those exceptions might be (*id.* at 45a). That vague order does little to alleviate the impact of the court's decision and it does nothing to eliminate the fundamental error in the court's legal analysis—the conclusion that the APA contains an independent limitation upon retroactive rulemaking.

partment of Energy, 795 F.2d 1021, 1025-1027 (Temp. Emer. Ct. App. 1986), cert. dismissed, No. 86-187 (Aug. 19, 1986); *National Ass'n of Independent Television Producers & Distributors* v. *FCC,* 502 F.2d 249, 255 nn. 10, 11 (2d Cir. 1974); *Daughters of Miriam Center for the Aged* v. *Mathews,* 590 F.2d at 1259-1260 (interpretive rule); *General Telephone Co.* v. *United States,* 449 F.2d 846, 863 (5th Cir. 1971); cf. *Illinois* v. *Bowen,* 786 F.2d 288, 292 (7th Cir. 1986) (upholding retroactive application of agency's new interpretation of existing rule). Prior decisions of the District of Columbia Circuit were to the same effect. *Citizens To Save Spencer County* v. *EPA,* 600 F.2d 844, 879-881 (D.C. Cir. 1979); see also *Maxcell Telecom Plus, Inc.* v. *FCC,* 815 F.2d 1551, 1554-1556 (D.C. Cir. 1987).

b. The court of appeals' interpretation of the Administrative Procedure Act is clearly wrong. The court of appeals relied (App., *infra,* 11a-12a) upon the statutory definition of a "rule," which states that a rule is "the whole or any part of any agency statement of general or particular applicability and future effect" designed to implement law or policy or describe the agency's organization and procedure (5 U.S.C. 551(4)). Seizing upon the phrase "future effect," the court concluded that a rule may not be given retroactive effect. But the legislative history of Section 551(4) makes plain that Congress did not intend to impose any such general restriction upon rulemaking authority. The reference to "future effect" was designed to distinguish rulemaking from adjudication, not to prohibit retroactive application of rules as a matter of course (see *Colyer* v. *Harris,* 519 F. Supp. 692, 694 (S.D. Ohio 1981)). Thus, under the APA, a "rule" is a statement of law or policy which is not applied or enforced in the same proceeding in which it is announced; any application or enforcement will occur *only in the future, i.e.,* in an adjudication.

This understanding is confirmed by the report of the ~~House Judiciary Committee, which added the phrase of the~~ House Judiciary Committee, which added the phrase "future effect" to the statutory definition of "rule." The committee's report explains that "[t]he phrase 'future effect' does not preclude agencies from considering and, so far as legally authorized, dealing with past transactions in prescribing rules for the future." H.R. Rep. 1980, 79th Cong., 2d Sess. App. A, n.1 (1946), *reprinted in, Legislative History of the Administrative Procedure Act, 1944-46,* at 283 n.1; see also *Attorney General's Manual on the Administrative Procedure Act* 37 (1947) ("[n]othing in the Act precludes the issuance of retroactive rules when otherwise legal and accompanied by" a finding of good cause).

The court of appeals also justified its interpretation of the APA by stating that retroactive rulemaking to correct an agency's procedural misstep is "completely at odds with basic tenets of administrative law" because "the effect of invalidating an agency rule is to '*reinstat[e]* the rules previously in force.' " App., *infra,* 13a (quoting *Action on Smoking & Health* v. *CAB,* 713 F.2d 795, 797 (D.C. Cir. 1983) (emphasis in the original)). But the court's premise is incorrect; invalidation of a rule does not generally reinstate the rules previously in force. Rather, the agency is free to reconsider the entire matter, with its decision subject to further judicial review. See *Burlington Northern, Inc.* v. *United States,* 459 U.S. 131, 142-144 (1982); *Motor Vehicle Manufacturers Ass'n* v. *State Farm Mutual Automobile Insurance Co.,* 463 U.S. 29, 57 & n.21 (1983); *Addison* v. *Holly Hill Fruit Products, Inc.,* 322 U.S. 607, 619-620 (1944); *Williams* v. *Washington Metropolitan Area Transit Comm'n,* 415 F.2d 922, 939-940 (D.C. Cir. 1968) (en banc), cert. denied, 393 U.S. 1081 (1969). Accordingly, the administrative agency is free to decide in the first instance whether to apply prior law to a case covered by the invalidated regulation or give retroactive effect to a subsequently-promulgated regulation. By completely eliminating administrative discretion to determine whether to accord retroactive effect to a rule, it is the court of appeals that has ignored basic principles of administrative law.[12]

The fact that retroactive rulemaking is permissible under the APA does not, of course, mean that an agency's decision to give a rule retroactive effect must be upheld in every case. The decision to apply the rule retroactively must be set aside if it is "arbitrary, capricious, an abuse of discretion, or otherwise not in accordance with law" (5 U.S.C. 706(2)(A)). The threshold inquiry is whether the substantive statute granting rulemaking authority imposes any restriction upon the agency's authority to apply rules retroactively. If no such limitation exists, a court must consider whether the agency's decision is arbitrary and capricious. The touchstone for that inquiry is this Court's decision in *SEC* v. *Chenery Corp.,* 332 U.S. 194 (1947), which upheld the retroactive application of a new principle of law in the context of an adjudication. The Court there stated that "such retroactivity must be balanced against the mischief of producing a result which is contrary to a statutory design or to legal or equitable principles. If that

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[12] Contrary to the court of appeals' apparent belief, *Action on Smoking & Health* v. *CAB, supra,* did not purport to establish a general principle that invalidation of a rule automatically reinstates the pre-existing rule. Rather, the reinstatement of the prior rule in that case was ordered only because an agency had engaged in "repeated technical noncompliance" with the APA (713 F.2d at 802). The court's general principle is also plainly unworkable. It would reimpose a prior regulation that the agency had already found to be unsatisfactory and that might be contrary to intervening statutory provisions. The agency must exercise its expertise to determine in the first instance the suitable course of action following a remand. Cf. *Vermont Yankee Nuclear Power Corp.* v. *Natural Resources Defense Council, Inc.,* 435 U.S. 519 (1978) (holding that a court may not impose additional procedural requirements on an agency).

mischief is greater than the ill effect of the retroactive application of a new standard, it is not the type of retroactivity which is condemned by law" (332 U.S. at 203). Other courts have elaborated upon the application of this balancing test in the rulemaking context. See, *e.g.*, *Texaco, Inc.* v. *Department of Energy*, 795 F.2d at 1025-1027; *Citizens to Save Spencer County* v. *EPA*, 600 F.2d at 879-881.

In addition, the retroactive application of the rule must be consistent with the Constitution. The Court has concluded that "[t]he retroactive aspects of legislation, as well as the prospective aspects, must meet the test of due process, and the justifications for the latter may not suffice for the former" (*Usery* v. *Turner Elkhorn Mining Co.*, 428 U.S. 1, 16-17 (1976)). That due process standard requires a "showing that the retroactive application of the [regulation] is itself justified by a rational * * * purpose" (*Pension Benefit Guaranty Corp.* v. *R.A. Gray & Co.*, 467 U.S. 717, 730 (1984)).

These tests are satisfied here. As we have discussed (see pages 11-12, *supra*), prior to incurring any of the costs that are subject to the 1984 rule, respondents had ample notice that the reasonableness of those costs would be assessed against the standard contained in that rule. Thus, respondents can have no reliance interest because the governing standard at the time they incurred the relevant costs was the standard that is contained in the current rule. In addition, the public interest weighs strongly in favor of applying the rule retroactively. Otherwise, respondents would gain a windfall—approximately $2 million in excess reimbursement.[13]

[13] The district court reached a contrary conclusion in applying the balancing test set forth in *Retail, Wholesale & Dep't Store Union* v. *NLRB*, *supra* (see App., *infra*, 35a-39a). Its analysis was flawed by its failure to recognize that respondents' reliance interest must be assessed as of the time they engaged in the underlying conduct. The court erroneously concluded that respondents had a cognizable reliance interest in retaining the windfall they obtained by virtue of the application of the flawed reimbursement standard. Cf. *Heckler* v. *Community Health Service of Crawford County, Inc.*, 467 U.S. 51 (1984). The court also erred in finding that the public interest weighed against the application of the revised methodology for calculation of the indices without first finding that that methodology was substantively invalid. If the methodology is valid, it is, by definition, the proper approach for calculating "reasonable" cost. Any award in excess of that amount violates the statute and therefore cannot be supported by the public interest.

3. The issues presented in this case are of considerable practical significance. The Secretary is obligated to administer the Medicare program in a manner that ensures that providers will be reimbursed for reasonable costs, as defined by the Secretary, and no more. See 42 U.S.C. (& Supp. III) 1395f(b). Because the decision of the court of appeals effectively deprives the Secretary of any realistic ability to adjust flawed reimbursement methodologies on a retroactive basis, even in the face of practical experience or audit data establishing the flaws in those methods, it will greatly hamper the Secretary's ability to perform his statutory duty. If defective cost reimbursement rules allow providers such as respondents to reap a windfall—or force them to suffer a shortfall—the Secretary simply will not be able to adjust those awards.[14]

Although the reasonable cost system of reimbursement for Medicare services has been replaced to some extent by the prospective payment system (see note 1, *supra*), many Medicare providers continue to obtain reimbursement for their "reasonable" costs by filing cost reports. See 42 C.F.R. 412.20-412.32 (rehabilitation hospitals, psychiatric

[14] The District of Columbia Circuit's limited view of the Secretary's authority is especially significant because the Medicare statute permits any provider to seek judicial review of a reimbursement determination in that Circuit (see 42 U.S.C. (Supp. III) 1395*oo*(f)(1)).

hospitals, children's hospitals, and hospitals with average length of stay greater than 25 days are not covered by PPS), 42 C.F.R. 413.1 (reasonable cost payment system applies to skilled nursing facilities, home health agencies, and other facilities providing services other than in-hospital care). Moreover, all providers are reimbursed for some categories of costs on a reasonable cost basis. See, *e.g.*, 42 U.S.C. (Supp. III) 1395ww(a)(4) (anesthesia services provided by nurse); 42 C.F.R. 412.2(d) (capital costs, direct medical education costs, cost for direct medical and surgical services provided by certain physicians in teaching hospitals). The questions presented here regarding the Secretary's authority to adjust reimbursement awards on a retroactive basis therefore have continuing importance for the administration of the Medicare program.[15]

The implications of the court of appeals' construction of the Administrative Procedure Act range far beyond the Medicare context. The court's decision seriously limits the regulatory authority of virtually every federal administrative agency.[16] By precluding retroactive rulemaking to correct procedural or technical missteps, the decision below permits plaintiffs, such as respondents here, to bootstrap procedural errors into substantive limitations upon the exercise of agency authority. That result will adversely affect an agency's ability to carry out its congressional mandate. The decision will also affect the government's litigating posture and the caseload of the federal appellate courts. If an agency cannot retroactively correct even an insignificant procedural error, the government will be forced to seek review of many more adverse lower court decisions in order to protect the agency's regulatory authority. The decision below thus threatens to burden the courts with issues that otherwise would have been resolved in the administrative process. For all of these reasons, review by this Court is plainly warranted.

[15] In addition, many disputes concerning hospitals' claims for reimbursement under the reasonable cost system are now pending on administrative and judicial review. The Department of Health and Human Services informs us that many of these cases involve challenges to the Secretary's authority to promulgate retroactive cost limit regulations.

[16] And, because almost all government agencies are subject to suit under the APA in the District of Columbia Circuit (see 28 U.S.C. 1391(e)), the court's decision will have nationwide impact.

CONCLUSION

The petition for a writ of certiorari should be granted.

Respectfully submitted.

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DECEMBER 1987

* The Solicitor General is disqualified in this case.

APPENDIX A

UNITED STATES COURT OF APPEALS FOR THE DISTRICT OF COLUMBIA CIRCUIT

No. 86-5381

GEORGETOWN UNIVERSITY HOSPITAL, ET AL.

v.

OTIS R. BOWEN, SECRETARY OF HEALTH AND HUMAN SERVICES, APPELLANT

No. 86-5382

HOWARD UNIVERSITY
AS HOWARD UNIVERSITY HOSPITAL, ET AL.

v.

OTIS R. BOWEN, SECRETARY OF HEALTH AND HUMAN SERVICES, APPELLANT

No. 86-5383

TUSCON GENERAL HOSPITAL

v.

OTIS R. BOWEN, SECRETARY OF HEALTH AND HUMAN SERVICES, APPELLANT

Appeals from the United States District Court
for the District of Columbia
(Civil Action Nos. 85-1845, 85-2545 and 85-2862)

Argued March 30, 1987
Decided June 26, 1987

Before: EDWARDS and STARR, *Circuit Judges,* and SWYGERT,* *Senior Circuit Judge,* United States Court of Appeals for the Seventh Circuit.

Opinion for the Court filed by *Circuit Judge* EDWARDS.

EDWARDS, *Circuit Judge*: In 1979, the Secretary of the Department of Health, Education and Welfare,[1] acting pursuant to section 223(b) of the Social Security Amendments of 1972,[2] promulgated a number of "cost limit" rules applicable to providers of routine inpatient hospital Medicare services. *See* 44 Fed. Reg. 31,806 (1979). The rules established limits on the amount of money that providers would be able to claim from the federal government as reimbursement for the costs incurred in the provision of Medicare services. Among the rules promulgated by the Secretary was a "wage index" formula, which would be used to calculate the cap on reimbursable wage costs. By its terms, the wage-index rule was to apply prospectively to cost accounting periods beginning on or after July 1, 1979. *Id.* at 31,806.

Two years later, in 1981, the Secretary modified the wage-index formula to exclude certain data that, in his view, reduced the accuracy of the index. *See* 46 Fed. Reg. 33,637, 33,639 (1981). The Secretary did so, however, without allowing for a notice and comment period. The

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* Sitting by designation pursuant to 28 U.S.C. § 294(d) (1982).

[1] Now the Department of Health and Human Services or "HHS."

[2] Codified at 42 U.S.C. § 1395x(v)(1)(A) (1982).

appellees—seven non-profit hospitals that provide routine inpatient Medicare services—challenged the Secretary's action in the District Court on the ground that notice and an opportunity for comment were required by section 553 of the Administrative Procedure Act ("APA"), 5 U.S.C. § 553 (1982). The trial court agreed with the appellees' contention and struck down the rule as violative of the APA. *See District of Columbia Hosp. Ass'n v. Heckler,* No. 82-2520, slip op. (D.D.C. Apr. 29, 1983), *reprinted in* Joint Appendix ("J.A.") 44-64; *Saint Cloud Hosp. v. Heckler,* No. 83-0223, slip op. (D.D.C. May 2, 1983), *reprinted in* J.A. 65-66. No appeal was taken from this ruling, and the Secretary, acting through fiscal intermediaries,[3] settled the appellees' accounts using the 1979 wage-index rule.

Three years later, the Secretary "reissued" the 1981 wage-index rule, this time adhering to the notice and comment procedures mandated by the APA. *See* 49 Fed. Reg. 46,495 (1984). Like the 1979 and 1981 cost-limit rules, the 1984 rule was promulgated under the authority of section 223(b). *See Proposed Notice,* 49 Fed. Reg. 6175, 6176 (1984). Unlike the 1979 and 1981 rules, however, the 1984 rule was given *retroactive* effect. Specifically, the rule was to cover cost accounting periods beginning on or after July 1, 1981—precisely those cost accounting periods that *would have been covered prospectively* by the Secretary's 1981 rule had that rule been promulgated in conformity with the procedural requirements of the APA. Pursuant to the retroactive rule, the fiscal intermediaries recalculated

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[3] 42 U.S.C. § 1395g(a) (1982) requires the Secretary to reimburse providers periodically during the fiscal year based on estimated costs for the year. At the end of the fiscal year, the Secretary is to make any "necessary adjustments on account of previously made overpayments or underpayments." The Secretary has contracted out these statutory responsibilities to insurance companies known as "fiscal intermediaries."

the amount owing to the appellees and recouped an amount in excess of two million dollars.

The appellees again filed suit in the District Court, challenging both the rule's retroactive application and its substantive validity. The District Court held that the reissued wage index was invalid insofar as it was applied to recoup monies from the appellees, and ordered the Secretary to reimburse the appellees with interest. *See Georgetown Univ. Hosp. v. Bowen*, No. 85-1845, slip op. at 24 (D.D.C. Apr. 11, 1986), *reprinted in* J.A. 94, 117. In reaching this result, the District Court principally concluded that the retroactive application of the rule was barred by the equitable principles enumerated by this circuit in *Retail, Wholesale & Department Store Union v. NLRB* ("*Retail Union*"), 466 F.2d 380 (D.C. Cir. 1972).[4]

We agree with the District Court that the Secretary's retroactive application of the 1984 cost-limit rule cannot stand, but we base our conclusion solely on the applicable provisions of the APA and the Medicare Act, and not on the equitable balancing test adopted by this circuit in *Retail Union*. The principles enunciated in *Retail Union* govern only those situations where a new policy is announced in the course of an administrative adjudication and applied retroactively to the participants in that adjudication. It does not apply in those situations where a

[4] The District Court was ambivalent about whether the Secretary had the statutory authority to promulgate a retroactive cost-limit rule. On the one hand, the court found that the APA and the Medicare Act seemed to preclude the issuance of such a retroactive rule. Slip op. at 15-16, *reprinted in* J.A. 108-09. On the other hand, the court observed that 42 U.S.C. § 1395x(v)(1)(A)(ii) (1982), which authorizes the Secretary to provide in his regulations for the "making of suitable retroactive corrective adjustments where, for a provider of services for any fiscal period, the aggregate reimbursement produced by the methods of determining costs proves to be either inadequate or excessive," arguably contemplated some degree of retroactive rulemaking authority. *Id.* at 16-17, *reprinted in* J.A. 109-10.

"legislative" rule is promulgated in accordance with the rulemaking procedures set forth in the APA. In these latter situations, a reviewing court must look both to the APA and to the agency's organic statute to discern the scope of the agency's rulemaking authority. When we do so in the instant case, we find that the Secretary's actions were clearly precluded both by the APA and the Medicare Act. Accordingly, we affirm the judgment of the District Court.

I. BACKGROUND

A. *Statutory Background*

The Medicare program, which subsidizes the medical care of the elderly and the infirm, was enacted by Congress in 1965 as Title XVIII of the Social Security Act. *See* Social Security Amendments of 1965, Pub. L. No. 89-97, 79 Stat. 286. Under the program, providers of covered services, such as hospitals and nursing homes, are generally reimbursed for "the lesser of (A) the reasonable cost of such services, as determined under section 1395x(v) . . . or (B) the customary charges with respect to such services." 42 U.S.C. § 1395f(b)(1) (1982 & Supp. III 1985). The instant case concerns only the "reasonable cost" provisions of 42 U.S.C. § 1395x(v).

As amended in 1972, section 1395x(v)(1)(A) defines "reasonable cost" as the "cost actually incurred, excluding therefrom any part of incurred cost found to be unnecessary in the efficient delivery of needed health services." The statute, however, does not require the Secretary to calculate the reasonable cost of Medicare services on a provider-by-provider basis. Rather, the Secretary is empowered to estimate the reasonable cost of providers by issuing regulations of general applicability. These regulations—denominated by statute as the "methods to be used . . . in determining . . . costs"—are presumed to measure

accurately that proportion of a provider's total costs that are attributable to the efficient treatment of Medicare beneficiaries. However, the Secretary is empowered by section 1395x(v)(1)(A)(ii) to provide in his regulations "for the making of suitable retroactive corrective adjustments where, for a provider of services for any fiscal period, the aggregate reimbursement produced by the methods of determining costs proves to be either inadequate or excessive." [5]

Prior to the 1972 amendments to section 1395x(v)(1)(A), the Secretary's ability to determine accurately the *reasonable cost* incurred by Medicare providers was somewhat limited. As the statute was originally drafted, the Secretary was empowered to establish cost accounting "methods" that would separate a provider's Medicare-related costs from its non-Medicare related costs.[6] However, the Secretary was *not* authorized to promulgate regulations determining—on a prospective basis—*what level* of Medicare-related costs would be considered "reasonable," and hence reimbursable.[7]

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[5] Section 1395x(v)(1)(A)(ii) will be referred to throughout the remainder of this opinion as the "retroactive corrective adjustments provision."

[6] *See* S. Rep. No. 404, 89th Cong., 1st Sess. 36, *reprinted in* 1965 U.S. CODE CONG. & ADMIN. NEWS 1943, 1976:

> Although [reimbursement] may be made on various bases the objective, whatever method of computation is used, will be to approximate as closely as practicable the actual cost (both direct and indirect) of services rendered to the beneficiaries of the program so that under any method of determining costs, the costs of services of individuals covered by the program will not be borne by individuals not covered, and the costs of services of individuals not covered will not be borne by the program.

[7] As the statute was originally drafted, the Secretary *did* have the authority to reduce reimbursements for those "items or services which are in excess of or more than" what would be considered "reasonable" under the Medicare Act. Pub. L. No. 89-97, § 1861(v)(2)(B), 79 Stat. 286, 323 (1965). However, this power was rarely exercised, both because of the difficulty of proving on a case-by-case basis that a particular item or service was excessively priced, and the "financial uncertainty" to providers caused by the retroactive disallowance of incurred costs. *See* S. Rep. No. 1230, 92d Cong., 2d Sess. 188 (1972) ("*Senate Report*"); H.R. Rep. No. 231, 92d Cong., 1st Sess. 83, *reprinted in* 1972 U.S. CODE CONG. & ADMIN. NEWS 4989, 5069-70 ("*House Report*").

To remedy this perceived deficiency in the statutory scheme, Congress amended section 1395x(v)(1)(A) in 1972 to authorize the Secretary to promulgate regulations establishing "limits on the direct or indirect overall incurred costs or incurred costs of specific items or services or groups of items or services to be recognized as reasonable based on estimates of the costs necessary in the efficient delivery of needed health services." *See* Social Security Amendments of 1972, Pub. L. No. 92-603, § 223(b), 86 Stat. 1329, 1393. In amending the statute, both Houses of Congress made clear their intent that this new authority was to be exercised on a prospective basis only: "[The authority] to set limits on costs . . . would be exercised on a prospective, rather than retrospective, basis so that the provider would know in advance the limits to Government recognition of incurred costs and have the opportunity to act to avoid having costs that are not reimbursable." *Senate Report* at 188; *House Report* at 83, *reprinted in* 1972 U.S. CODE CONG. & ADMIN. NEWS at 5070. Thus, by virtue of this amendment, the Secretary's statutory authority to establish "methods of determining costs" extends to the promulgation of prospective "cost limit" rules. *See Regents of the Univ. of Cal. v. Heckler,* 771 F.2d 1182, 1189 (9th Cir. 1985) ("The 1972 amendments, in authorizing the Secretary to adopt cost limits, merely added another method of cost calculation to those already recognized as legitimate by the statute.").

B. *Factual Background*

The cost-limit rule at issue in this case was first promulgated by the Secretary in 1979, explicitly pursuant to his statutory authority "to set prospective limits on the costs that are reimbursed under Medicare." 44 Fed. Reg. 31,806, 31,806 (1979). The rule, which governed only the provision of routine inpatient hospital services,[8] established a wage-index formula to be used to calculate the cap on reimbursable wage costs. The wage index for an individual hospital was to be calculated by dividing the "local" average hospital wage by the "national" average hospital wage.[9] Bureau of Labor Statistics ("BLS") data was to be used in calculating the applicable indexes. *See id.* at 31,807-08.

In 1981, the Secretary made an adjustment to the formula used to calculate the wage indexes. Specifically, the Secretary decided to exclude data on the wages paid by federally-owned hospitals. *See* 46 Fed. Reg. 33,637, 33,639 (1981). The Secretary reasoned that the wage-index formula—which was designed to measure variations in local wage rates—would be more accurate without the inclusion of this wage data, because federally-owned hospitals typically paid their employees according to

[8] In 1983, Congress enacted a new "prospective payment system" to be used by the Secretary in determining the appropriate level of reimbursement for inpatient hospital services. *See* 42 U.S.C. § 1395ww(d) (Supp. III 1985). Under that new system, providers of inpatient hospital services are reimbursed on the basis of predetermined rates. This change does not affect the instant appeal, which concerns only reimbursements for costs incurred prior to 1983.

[9] If the hospital was located within a Standard Metropolitan Statistical Area ("SMSA"), the appropriate "local" figure would be the average hospital wage within that SMSA, and the appropriate "national" figure would be the average hospital wage among all SMSAs. If the hospital was located outside of a SMSA, the appropriate "local" and "national" figures would be calculated using non-SMSA wage data.

national rather than local wage rates. *Id.* at 33,639. The Secretary made this revision in his cost-limit rule without allowing for a notice and comment period.

The appellees filed two separate actions in the District Court seeking to overturn the rule on the ground that the Secretary had failed to comply with the procedural requirements of section 553 of the APA, 5 U.S.C. § 553 (1982). The trial court found in favor of the appellees and invalidated the rule. *See District of Columbia Hosp. Ass'n v. Heckler,* No. 82-2520, slip op. (D.D.C. Apr. 29, 1983), *reprinted in* J.A. 44-64; *Saint Cloud Hosp. v. Heckler,* No. 83-0223, slip op. (D.D.C. May 2, 1983), *reprinted in* J.A. 65-66. The Secretary filed an appeal from the trial court's ruling, but voluntarily dismissed the appeal on September 1, 1983. Pursuant to the trial court's decision, the fiscal intermediaries settled the appellees' accounts using the Secretary's original wage-index formula, *i.e.*, the wage-index formula that *included* federal-hospital data.

In February of 1984, the Secretary published a Notice of Proposed Rulemaking in which he proposed to "re-issue" the 1981 wage-index rule. 49 Fed. Reg. 6175 (1984). Although the notice explicitly stated that the Secretary was authorized by statute to establish "prospective" cost-limit rules, the "reissued" rule was to apply retroactively to cost accounting periods dating back to July of 1981. *Id.* In other words, the rule was to apply to cost accounting periods that would have been covered prospectively by the Secretary's 1981 rule had that rule been promulgated in accordance with the procedural requirements of the APA.

After a comment period, the Secretary published a final notice announcing his decision to "reissue" the 1981 wage-index rule. 49 Fed. Reg. 46,495 (1984). In rejecting the contention of one commenter that he was without authority to promulgate a retroactive rule, the Secretary opined that the rule was not truly "retroactive" in nature, because hospitals were on notice in 1981 that he intended to ex-

clude federal-hospital data from the wage index. *Id.* at 46,497. Under the circumstances, the Secretary viewed the "retroactive" rule as a legitimate attempt to correct the procedural defect that had prompted the District Court to invalidate the rule in the first instance. *Id.*

Pursuant to the rule, the Secretary instructed the fiscal intermediaries to reopen earlier cost accounting periods and recalculate the amount owing to the appellees using a wage-index formula that *excluded* federal-hospital data. The fiscal intermediaries did so, recouping an amount in excess of two million dollars from the seven appellee hospitals. The appellees again filed suit in the District Court, which invalidated the Secretary's action on the ground that retroactive application of the 1984 rule violated the equitable principles enunciated by this court in *Retail Union. See Georgetown Univ. Hosp. v. Bowen,* No. 85-1845, slip op. at 17-22 (D.D.C. Apr. 11, 1986), *reprinted in* J.A. 94, 110-15. The Secretary filed this appeal.

II. ANALYSIS

A. *The Secretary's Retroactive Rule Was Barred by the APA*

In its opinion, the District Court found that both the APA and the Medicare Act appeared to preclude the Secretary from promulgating a retroactive cost-limit rule. However, the court declined to rest its judgment on that ground. Perceiving conflicting signals from Congress on the question of the Secretary's statutory authority, *see* note 4 *supra,* the trial court turned to this circuit's decision in *Retail Union,* where we articulated certain equitable considerations relevant to the question whether an agency may give retroactive effect to new policies adopted in the course of *adjudication.*[10] Based on the considerations

[10] Those equitable considerations include: (1) whether the issue raised in the adjudication is one of first impression; (2) whether the new policy is an abrupt departure from well-established agency practice; (3) the extent to which the parties to the adjudication relied on the old policy; and (4) the burden imposed on the parties by retroactive application of the new policy. These considerations must be balanced against the statutory interest in applying the new policy retroactively. *See* 466 F.2d at 390.

enumerated in *Retail Union,* the trial court held that the Secretary's rule was invalid insofar as it was applied to recoup monies from the appellees.

We uphold the judgment of the District Court, but for reasons distinct from those identified in *Retail Union.* In *Retail Union,* the court was careful to distinguish between new policies adopted in the course of adjudication, and rules adopted pursuant to rulemaking procedures under the APA. Policies adopted in the course of adjudication, the court held, may be applied retroactively, unless the inequities produced by retroactive application are not counterbalanced by sufficiently significant statutory interests. *See* 466 F.2d at 390; *cf. Yakima Valley Cablevision, Inc. v. FCC,* 794 F.2d 737, 745-46 (D.C. Cir. 1986) (noting the "troubling nature" of retroactive policymaking, and observing that this court, beginning with *Retail Union,* "has developed factors to guide our determination of whether an agency may give retroactive effect to a new policy developed in adjudication"). The court in *Retail Union* went on to observe, however, that Congress had devised an "*alternative procedure,*" *i.e.,* rulemaking under the APA, by which the inequities of retroactive policymaking could be avoided altogether. 466 F.2d at 388 (emphasis added). The court made clear that a balancing of the equities is unnecessary in those situations where this "alternative procedure" is utilized, because rules adopted pursuant to rulemaking procedures under the APA are to be "prospective in application only." *Id.* (citing the definitional section of the APA, 5 U.S.C. § 551 (1982), which distinguishes a "rule" from an "adjudication," and defines

the former as "an agency statement of general or particular applicability and *future effect*" (emphasis added)); *cf. SEC. v. Chenery Corp.*, 332 (U.S. 194, 202 (1947) (distinguishing between the "quasi-legislative promulgation of [general] rules to be applied in the future," and adjudicatory orders that may in appropriate circumstances, be given retroactive effect); *Wisconsin Gas Co. v. FERC*, 770 F.2d 1144, 1166 (D.C. Cir. 1985) (distinguishing between trial-type procedures and "notice and comment rulemaking, [which is] particularly appropriate for determination of legislative facts and policy of general, prospective applicability"), *cert. denied*, 106 S. Ct. 1968 (1986); *Telocator Network of America v. FCC*, 691 F.2d 525, 551 (D.C. Cir. 1982) (same); *PBW Stock Exchange, Inc. v. SEC*, 485 F.2d 718, 732 (3d Cir. 1973) ("[R]ules ordinarily look to the future and are applied prospectively only. . . ."), *cert. denied*, 416 U.S. 969 (1974).[11]

[11] The fact that the APA requires legislative rules to be given only "future effect" is underscored by 5 U.S.C. § 553(d) (1982), which requires that such rules be published not less than 30 days before their effective date, except "as otherwise provided by the agency for good cause found and published with the rule." On one occasion, this circuit has suggested that, in unique circumstances, the "good cause" exception to the 30-day effective date requirement might justify legislative rules of limited retroactive effect. *See Citizens to Save Spencer County v. EPA*, 600 F.2d 844, 879-81 (D.C. Cir. 1979). The decision in *Spencer County* is not only extremely limited, but the narrow exception that it purports to recognize has never been accepted by any other panel of this court. This is hardly surprising, because § 553(d) appears only to contemplate a narrow exception to the 30-day requirement for rules that, for good cause shown, must be given effect either immediately upon promulgation, or in less than 30 days; neither § 553(d), nor any other provision of the APA, permits rules of retrospective effect.

In any event, we need not examine the precise meaning of § 553(d) here, because the reasons advanced by the Secretary in his notice for promulgating a retroactive rule plainly do not bring that rule within any conceivable "good cause" exception.

The instant case does not in any way involve a new agency policy articulated in the course of adjudication. Rather, it involves a *legislative rule* adopted by the Secretary pursuant to the notice and comment procedures of the APA, 5 U.S.C. § 553 (1982). As recognized in *Retail Union* itself, the APA requires that legislative rules be given future effect only. Because of this clear statutory command, equitable considerations are irrelevant to the determination of whether the Secretary's rule may be applied retroactively; such retroactive application is foreclosed by the express terms of the APA.

In his final rulemaking notice, the Secretary suggested that a retroactive rule was warranted under the circumstances of this case to correct what was simply a "procedural defect" in his previous rule. *See* 49 Fed. Reg. 46,495, 46,497 (1984). It is clear, however, that this proffered exception to the requirement that legislative rules be prospective in effect only is completely at odds with basic tenets of administrative law. This circuit has previously held that the effect of invalidating an agency rule is to "*reinstat[e]* the rules previously in force." *Action on Smoking & Health v. CAB*, 713 F.2d 795, 797 (D.C. Cir. 1983) (emphasis added); *accord Menorah Medical Center v. Heckler*, 768 F.2d 292, 297 (8th Cir. 1985); *Abington Memorial Hosp. v. Heckler*, 750 F.2d 242, 244 (3d Cir. 1984), *cert. denied*, 106 S. Ct. 180 (1985). Accordingly, when the District Court vacated the Secretary's *1981* wage-index rule, it necessarily reinstated the Secretary's *1979* rule, which required the Secretary to reimburse providers using a formula that included federal-hospital data. Well aware of the import of the District Court's ruling, the Secretary reimbursed the appellee hospitals using the 1979 wage-index formula. The Secretary's 1984 rule obviously can have no application to cost accounting periods that were, by virtue of the District Court's ruling, governed by the Secretary's 1979 rule. *Cf. Greene v. United States*, 376

U.S. 149, 160 (1964) (because 1955 regulation was in effect when the petitioner's claim to monetary compensation was asserted, the government could not compel the petitioner to establish his entitlement to compensation under a revised 1960 regulation).

The Secretary's suggestion that retroactive rulemaking is permissible to remedy a procedural defect in a rule would, if accepted, make a mockery of the provisions of the APA. Obviously, agencies would be free to violate the rulemaking requirements of the APA with impunity if, upon invalidation of a rule, they were free to "reissue" that rule on a retroactive basis. If an agency rule is invalidated on procedural grounds, the agency must, of course, be given an opportunity to correct the procedural defect and promulgate a new rule. *See, e.g., Action on Smoking & Health,* 713 F.2d at 798. However, both the express terms of the APA and the integrity of the rulemaking process demand that the corrected rule, like all other legislative rules, be prospective in effect only.

B. *The Secretary's Retroactive Rule is Also Inconsistent With the Medicare Act*

Although Congress has expressed a clear intention in the APA not to authorize retroactive agency rulemaking, Congress may—subject to any applicable constitutional constraints[12]—override the general terms of the APA by explicitly authorizing retroactive regulations in an agency's organic statute. However, just as substantive legislation will not be given retroactive effect "unless such be 'the unequivocal and inflexible import of the [statutory] terms,

[12] *See generally* Hochman, *The Supreme Court and the Constitutionality of Retroactive Legislation,* 73 HARV. L. REV. 692 (1960); Slawson, *Constitutional and Legislative Considerations in Retroactive Lawmaking,* 48 CALIF. L. REV. 216 (1960).

and the manifest intention of the legislature,' "[13] an organic statute will not be read to authorize an agency to engage in retroactive rulemaking unless it is clear from the terms of the statute that Congress intended such an unusual delegation of power. In the instant case, it is clear from the terms and the legislative history of the Medicare Act that Congress did *not* intend to empower the Secretary to promulgate retroactive cost-limit rules. Thus, the Secretary's actions in this case are barred not only by the APA, but by the Medicare Act as well.

As outlined earlier, Congress amended section 1395x(v)(1)(A) of the Medicare Act in 1972 to authorize the Secretary to promulgate cost-limit regulations. In amending the statute, both Houses of Congress made it abundantly clear that this authority was to be exercised on a prospective basis only: "[The authority] to set limits on costs . . . would be exercised on a prospective, rather than retrospective, basis so that the provider would know in advance the limits to Government recognition of incurred costs and have the opportunity to act to avoid having costs that are not reimbursable." *Senate Report* at 188; *House Report* at 83, *reprinted in* 1972 U.S. CODE CONG. & ADMIN. NEWS at 5070.

Since 1972, the Secretary has consistently interpreted section 1395x(v)(1)(A) to authorize cost-limit rules that are prospective in application only. *See, e.g.,* 42 C.F.R. § 413.30 (1986); *Beth Israel Hosp. v. Blue Cross Assoc.,* [1981-1982 Transfer Binder] Medicare & Medicaid Guide (CCH) ¶ 31,645, at 10,136-37 (Nov. 7, 1981). Indeed, on each occasion that the Secretary has promulgated a wage-index rule—*including the rule challenged here on the grounds of retroactivity*—the Secretary has explicitly noted that he is authorized by statute to establish *prospec-*

[13] *Greene v. United States,* 376 U.S. 149, 160 (1964) (quoting *Union Pac. R.R. v. Laramie Stock Yards Co.,* 231 U.S. 190, 199 (1913)).

tive cost-limit rules. In light of the clear congressional intent, and the uninterrupted agency practice, we are astonished that the Secretary now purports to have the authority to promulgate such rules on a retroactive basis.

At no point in this litigation, either in the District Court or on appeal, has the Secretary disputed the fact that Congress amended the Medicare Act in 1972 to authorize *prospective* cost-limit rules. Nevertheless, the Secretary contends that a retroactive cost-limit rule was authorized under the present circumstances by section 1395x(v)(1)(A)(ii), the retroactive corrective adjustments provision. We cannot agree.

First, we note that the Secretary explicitly promulgated the retroactive rule under section 223 of the Social Security Amendments of 1972—the very provision that Congress added to the Medicare Act to authorize *prospective* cost-limit rules. It was not until the litigation in the District Court that the Secretary sought to invoke the retroactive corrective adjustments provision as authority for the rule. In light of the APA's requirement that notice of proposed rules contain "reference to the legal authority under which the rule is proposed," 5 U.S.C. § 553(b)(2) (1982), and that final rules be accompanied by "a concise general statement of their *basis* and purpose," *id.* § 553(c) (emphasis added), the Secretary's belated attempt to justify the rule under the retroactive corrective adjustments provision must fail.

Second, even if we were to entertain the Secretary's belated invocation of section 1395x(v)(1)(A)(ii), we would conclude that the Secretary's actions here were not authorized by the statute. Although our sister circuits have struggled to define the precise contours of the retroactive corrective adjustments provision,[14] that provision is

[14] *See, e.g., Tallahassee Memorial Regional Medical Center v. Bowen,* 815 F.2d 1435 (11th Cir. 1987); *Mason Gen. Hosp. v. Secretary of HHS,* 809 F.2d 1220 (6th Cir. 1987); *Regents of the Univ. of Cal. v. Heckler,* 771 F.2d 1182 (9th Cir. 1985); *Fairfax Nursing Center v. Califano,* 590 F.2d 1297 (4th Cir. 1979); *Daughters of Miriam Center for the Aged v. Mathews,* 590 F.2d 1250 (3d Cir. 1978); *Adams Nursing Home v. Mathews,* 548 F.2d 1077 (1st Cir. 1977); *Springdale Convalescent Center v. Mathews,* 545 F.2d 943 (5th Cir. 1977); *Kingsbrook Jewish Medical Center v. Richardson,* 486 F.2d 663 (2d Cir. 1973).

plainly *not*—as the Secretary would have it—broad authority for the promulgation of retroactive cost-limit rules. Rather, the provision is narrowly drawn to allow the Secretary to make "*corrective adjustments* where, *for a provider of services* for any fiscal period, the aggregate reimbursement produced by the [Secretary's] methods of determining costs *proves to be* either inadequate or excessive." 42 U.S.C. § 1395x(v)(1)(A)(ii) (emphasis added).

As the highlighted language illustrates, there is a critical distinction between the power to promulgate retroactive rules of general application and the power to make retroactive corrective adjustments in the reimbursements of particular providers whose aggregate reimbursements are shown to be either "inadequate or excessive." The former power—if it existed—would be exceedingly broad, for it would permit the Secretary to issue a modified cost-limit rule, and then automatically apply that rule across the board to all providers who had been reimbursed under the predecessor rule. The latter power, however, is far more limited, for it only allows the Secretary to adjust the reimbursements of particular providers upon proof that his "methods of determining costs" (including his cost-limit rules) resulted in inadequate or excessive reimbursements to those providers.

To emphasize the importance of this distinction, it is necessary to focus in on the workings of the statutory scheme. As outlined earlier, the Secretary's "methods of determining costs" are the means by which the Secretary estimates the "reasonable cost" incurred by all providers of Medicare services, defined by statute as the "cost actually

incurred, excluding therefrom any part of incurred cost found to be unnecessary in the efficient delivery of needed health services." 42 U.S.C. § 1395x(v)(1)(A) (1982). Like any measuring device, the Secretary's regulations will be subject to a certain degree of error, inevitably resulting in "inadequate" or "excessive" reimbursements to *some providers*. Where the Secretary is able to prove that inadequate or excessive reimbursements to a provider have resulted from his "methods of determining costs," he may make "suitable retroactive corrective adjustments." *Id.* § 1395x(v)(1)(A)(ii).[15]

The administrative record is devoid of any indication that corrective adjustments in the appellees' reimbursements were warranted on the facts of this case.[16] Absent

[15] Although the Secretary is authorized by statute to make retroactive corrective adjustments, we reject out of hand the Secretary's contention that the exercise of such authority is subject to no time limitation. The Secretary infers the absence of any temporal restriction on his authority to make retroactive adjustments from the use of the phrase "*any* fiscal period" in § 1395x(v)(1)(A)(ii) (emphasis added). We agree with the Eleventh and Sixth Circuits, however, that the use of the word "any" does not suggest that the Secretary has the awesome power to reopen a provider's account years or even decades after that account has been settled. *See Tallahassee Memorial Regional Medical Center v. Bowen*, 815 F.2d 1435, 1453-54 (11th Cir. 1987); *Mason Gen. Hosp. v. Secretary of HHS*, 809 F.2d 1220, 1225-26 (6th Cir. 1987). Had Congress intended to delegate such boundless authority to the Secretary, it would, we submit, have said so more directly and unambiguously.

[16] The fact that the appellees arguably are entitled to lower reimbursements under the Secretary's new rule does *not* establish that they were reimbursed in excess of their reasonable costs under the prior rule. It is equally plausible that the Secretary's new rule understates the reasonable costs incurred by the appellees in prior cost accounting periods, as the appellees have maintained throughout this litigation.

The appellees argue—and the District Court specifically found—that the Secretary's new wage-index rule understates their reasonable costs, principally because the index does not distinguish

an evidentiary showing that the appellees received excessive reimbursements under the prior wage-index rule, there was no basis for even a timely invocation of the retroactive corrective adjustments provision. We therefore hold that the Secretary acted in contravention of the APA and the Medicare Act by recouping past reimbursements from the appellees, and that those reimbursements must be restored.

III. CONCLUSION

For the reasons set forth above, the judgment of the District Court is

Affirmed.

between those hospitals located within the urban "core" of a SMSA, and those hospitals located within the suburban "ring" of a SMSA (the purported distinction being that hospitals in urban cores are forced to pay higher wages to entice talented personnel). *See* Brief of Plaintiffs/Appellees at 39-45; *Georgetown Univ. Hosp. v. Bowen*, No. 85-1845, slip op. at 19-20 (D.D.C. Apr. 11, 1986), *reprinted in* J.A. 94, 112-13; *see also Final Notice*, 49 Fed. Reg. 46,495, 46,498 (1984) (conceding that a wage index that differentiates urban "cores" from suburban "rings" could "[i]n principle" provide a "more precise" wage index, but finding that such an index is infeasible "due to certain limitations of the BLS data used to construct the wage index"). Whether the appellees are indeed correct in this assertion, however, is irrelevant to the proper disposition of this appeal. The Secretary's actions here must fail because he made no attempt to demonstrate that the appellees had received excessive reimbursements under the prior rule, and therefore laid no foundation for the application of the retroactive corrective adjustments provision. Only if the Secretary had attempted such an evidentiary showing would we need to examine the appellees' substantive claims.

APPENDIX B

UNITED STATES DISTRICT COURT
FOR THE DISTRICT OF COLUMBIA

Civil Action No. 85-1845

GEORGETOWN UNIVERSITY HOSPITAL, ET AL., PLAINTIFFS

v.

OTIS R. BOWEN,* SECRETARY OF THE DEPARTMENT OF HEALTH AND HUMAN SERVICES, DEFENDANT

Civil Action No. 85-2545

HOWARD UNIVERSITY
AS HOWARD UNIVERSITY HOSPITAL, ET AL., PLAINTIFFS

v.

OTIS R. BOWEN,* SECRETARY OF THE DEPARTMENT OF HEALTH AND HUMAN SERVICES, DEFENDANT

Civil Action No. 85-2862

TUSCON GENERAL HOSPITAL, PLAINTIFF

v.

OTIS R. BOWEN,* SECRETARY OF THE DEPARTMENT OF HEALTH AND HUMAN SERVICES, DEFENDANT

[Filed Apr. 11, 1986]

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* Otis R. Bowen is substituted for Margaret M. Heckler pursuant to Fed. R. Civ. P. 25(d).

MEMORANDUM

Plaintiff health care providers in these consolidated cases challenge the retroactive wage index rule published by the Secretary of Health and Human Services on November 26, 1984. Fiscal intermediaries, applying this retroactive wage index rule, have recouped monies previously paid to plaintiffs. Plaintiffs seek a determination that the retroactive wage index rule is invalid, and reimbursement of the monies recouped under that rule by the fiscal intermediaries. Presently before the Court are the parties' cross motions for summary judgment. All issues have been thoroughly briefed and orally argued.

I.

This suit continues a controversy that commenced in 1981 when the Secretary published a schedule of Medicare routine cost limits without having first published notice and received comments. For each of the seven years before 1981 the Secretary had published an annual schedule of limits on hospital costs reimbursable under the Medicare Act only after publishing a notice of proposed rulemaking and receiving comments solicited by that notice, pursuant to the Administrative Procedure Act ("APA"), 5 U.S.C. § 553. On June 30, 1981, however, the Secretary published a "Final Notice" of the 1981 "Schedule of Limits on Hospital . . . Costs," 46 Fed. Reg. 33637 (June 30, 1981), without having first published notice and received comments. Significantly, the 1981 schedule used a formula for calculating the hospital wage index that excluded data from federal hospitals in the Standard Metropolitan Statistical Area ("SMSA").

The preamble to the June 30 Notice stated

> In developing the wage index used for the revised limits, we have also excluded data from federal government hospitals. Because these hospitals typi-

> cally use national pay scales, the amounts they pay their employees do not necessarily reflect area wage levels. We believe excluding data from these hospitals will help improve the accuracy of the wage index adjustment.

46 Fed. Reg. at 33639.

The Secretary's June 30, 1981 wage index rule was challenged in a suit filed in this Court on September 9, 1982, by three District of Columbia hospitals and the District of Columbia Hospital Association, which represented the interests of fifteen similar hospitals in the District of Columbia. Each of those hospitals would have been reimbursed less under the Secretary's 1981 wage index rule than they would have been under the pre-existing wage index, which included federal hospital data.

By Memorandum and Order of April 29, 1983, this Court invalidated the Secretary's June 30, 1981 wage index rule because it was promulgated without notice and comment. *District of Columbia Hospital Association [DCHA] v. Heckler,* No. 82-2520, slip op. (D.D.C. April 29, 1983). That Memorandum stated:

> If the Secretary wishes to put in place a valid *prospective* wage index, she should begin proper notice and comment proceedings; any wage index currently in place that has been promulgated without notice and comment is invalid as was the 1981 schedule.

Id. at 19 (emphasis added) (footnote omitted). The April 29 decision became final on September 1, 1983, when the Secretary voluntarily dismissed her appeal from that decision. After the *DCHA* opinion, the Medicare fiscal intermediaries settled these plaintiffs' cost reports for years subject to the 1981 schedule, using a wage index that included federal hospital data.

On February 17, 1984, the Secretary published a proposed notice reissuing the wage index originally contained in the 1981 schedule of cost limits. 49 Fed. Reg. 6175

(February 17, 1984). On November 26, 1984, the Secretary, "after consideration of comments," issued a final notice reaffirming the use of the wage index that was used to calculate the June 30, 1981 schedule of cost limits. 49 Fed. Reg. 46495 (November 26, 1984). The November 26 Notice stated that it was "[e]ffective December 26, 1984" and applied to "cost reporting periods ending after September 30, 1981, as well as cost reporting periods beginning on or after October 1, 1981, and before October 1, 1982." *Id.* Fiscal intermediaries then applied this retroactive wage index to recoup monies previously reimbursed to plaintiffs for these cost reporting periods under the wage index that included federal hospital data.

Pursuant to 42 U.S.C. § 1395oo(f)(1), plaintiffs sought and obtained certification from the Provider Reimbursement Review Board ("PRRB") that it lacked authority to resolve the providers' challenges to the retroactive wage index rule. The parties do not dispute that the agency's determination thus constitutes a final decision properly before this Court for judicial review under applicable provisions of the APA, 5 U.S.C. § 701 *et seq. See* 42 U.S.C. § 1395oo(f).

II.

A.

Plaintiffs contend that the Secretary's retroactive wage index rule is invalid: (1) under Medicare Act provisions authorizing the establishment of Medicare cost limits; (2) under APA provisions and case law interpreting those provisions; (3) under the standards applied to determine whether rules should be given retroactive effect; and (4) for violation of the Secretary's own regulations on cost limits indicating that they are to be given *prospective* effect.

Plaintiffs first note that in 1972 Congress amended the Medicare Act—specifically 42 U.S.C. § 1395(x)(v)(1)(A)—to authorize the Secretary to establish Medicare cost limits. *See* Pub. L. No. 92-603, § 223(b). According to plaintiffs, an examination of the legislative history establishes that limits set under § 223 must be "exercised on a prospective, rather than retrospective, basis so that the provider would know in advance the limits to Government recognition of incurred costs and have the opportunity to act to avoid having costs that are not reimbursable." H.R. Rep. No. 92-231, 92d Cong., 1st Sess. 83 (1971); S. Rep. No. 92-1230, 92d Cong., 2d Sess. 188 (1972). Thus, plaintiffs assert, the Secretary's wage index rule is invalid because its retroactivity is contrary to the intent of Congress.

Plaintiffs' second contention is that the Secretary's action violates applicable APA provisions and case law interpreting the APA. Plaintiffs note that under the APA, a "rule" is defined as "the whole or part of an agency statement of general or particular applicability and *future effect* . . . ." 5 U.S.C. § 551(4) (emphasis added). Rules adopted under the APA "are prospective in application only." *Retail, Wholesale and Department Store Union, AFL-CIO v. NLRB,* 466 F.2d 380, 388 (D.C. Cir. 1972). Plaintiffs distinguish *adjudicative* rulemaking, which may under certain circumstances be given retroactive effect, from notice and comment rulemaking, which, plaintiffs assert, should not have retroactive application. *Compare Citizens to Save Spencer City v. USEPA,* 600 F.2d 844, 880 (D.C. Cir. 1979) (Supporting "the general principle that agency [notice and comment] rulemaking, whenever possible, should be prospective only in effect," but finding in the particular circumstances good cause for retroactive application).

Plaintiffs assert that even in the context of adjudicative rulemaking, retroactivity is disfavored. Our Court of Appeals has discussed the factors to be considered in determining whether a rule should be given retroactive application:

> (1) Whether the particular case is one of first impression,
>
> (2) Whether the new rule represents an abrupt departure from well established practice or merely attempts to fill a void in an unsettled area of law,
>
> (3) the extent to which the party against whom the new rule is applied relied on the former rule,
>
> (4) the degree of the burden which a retroactive order imposes on a party, and
>
> (5) the statutory interest in applying a new rule despite the reliance of a party on the old standard.

Retail Union, supra, 466 F.2d at 390. Plaintiffs contend that examination of these factors yields the conclusion that the wage index rule should not be given retroactive effect.

Exploring the *Retail Union* factors, plaintiffs first quote from that opinion:

> Whether a case is of "first impression" is important because "to deny the benefits of a change in the law to the very parties whose efforts were largely responsible for bringing it about might have adverse effects on the incentive of litigants to advance new theories or to challenge outworn doctrines."

Plaintiffs' Statement of Material Fact Not In Dispute at 14 (filed October 21, 1985) (quoting *Retail Union, supra,* 466 F.2d at 390). Similarly, plaintiffs contend, it trivializes APA procedural requirements and significantly discourages litigants like plaintiffs if the Secretary can, after invalidation of a rule for procedural defects, simply engage in *pro forma* procedural corrections and retroactively re-issue the rule against those who successfully challenged it initially.

Regarding the second *Retail Union* factor, plaintiffs contend that the retroactive rule constitutes an abrupt departure from the previous practice of including federal hospital data in the wage index. Plaintiffs note that the result of the Court's action in *DCHA* in invalidating the 1981 schedule was to reinstate the previous index including federal hospital data:

> To "vacate," as the parties should well know, means "to annul; to cancel or rescind; to declare, to make, or to render void; to defeat; to deprive of force; to make of no authority or validity; to set aside." [Citations omitted.] Thus, by vacating or recinding the recissions proposed by ER-1245, the judgment of this court had the effect of reinstating the rules previously in force . . . .

Action on Smoking and Health v. CAB, 713 F.2d 795, 797 (D.C. Cir. 1983). Thus, plaintiffs assert, the *DCHA* decision invalidating the 1981 schedule reinstated the prior index including federal hospital data. That index continued in force until the unexpected retroactive application in late 1984 of the reissued wage index rule, which thus constituted an "abrupt departure."

Regarding other *Retail Union* factors, plaintiffs assert that they relied on the prior rule and expected that the Secretary would behave lawfully. They further assert that retroactive application clearly imposes a substantia burden on them, representing without contradiction that $400,000 was recouped from four plaintiffs and $1,000,000 from one plaintiff.

As to the final *Retail Union* factor, plaintiffs contend that no statutory interest supports retroactive application of the reissued wage index rule. Plaintiffs explore the merits of the reissued wage index rule and argue, supported by Bureau of Labor Statistics ("BLS") data, that the Secretary is erroneous in her belief that the wage index

rule excluding federal hospital data results in more accurate cost reimbursement. Plaintiffs contend that the Secretary has critically erred by failing to differentiate between hospitals in the urban "core" of an SMSA and those in the suburban "ring." Essentially, plaintiffs argue that they, as urban core hospitals, must compete for employees with federal hospitals in a manner that most suburban "ring" non-federal hospitals do not. Accordingly, exclusion of the federal data fails to account for market forces with significant impact on plaintiffs' costs and results in under-reimbursement. In support of this contention, plaintiffs recite BLS data that indicate that the wage index for non-federal hospitals in the urban core of the D.C. SMSA is 1.3286. The wage index for the entire SMSA, *including* federal hospitals, is 1.1953; the wage index for the entire SMSA *excluding* federal hospital data is 1.1547. *See* Plaintiffs' Statement of Material Facts, *supra* at 33. The Secretary's reissued rule applies the equivalent of the latter index—thus forcing plaintiffs even farther away from the index (the first) that accurately reflects market forces operating on their costs.

Plaintiffs further contend that the retroactive application of the wage index rule necessarily involves violation of the APA's requirement that published rules have a thirty day delayed effective date. *See* 5 U.S.C. § 553(d). The purpose of the thirty day delayed effective date rule is to "afford persons affected a reasonable time to prepare for the effective date of a rule or rules or to take any other action which the issuance of rules may prompt." S. Rep. No. 752, 79th Cong., 1st Sess. 15 (1946); H.R. Rep. No. 1980, 79th Cong. 2d Sess. 25 (1946). Retroactive application of the revised rule, plaintiffs contend, denies them this opportunity. Plaintiffs also contend that the Secretary has not provided an adequate basis and purpose statement supporting the reissuance of the rule.

Finally, plaintiffs contend that the Secretary's action violates his own regulations which require that cost limits be given *prospective* effect. Plaintiffs note that initial versions of 42 C.F.R. § 405.460(a), the cost limit regulations, promulgated on June 6, 1974, expressly stated that "[t]hese limits will be imposed *prospectively* . . . ." 39 Fed. Reg. 20165 (June 6, 1974) (emphasis added). The cost limit regulations were revised June 1, 1979; as revised, § 405.460(b)(3) stated:

> *Prior to the beginning of a cost period to which limits will be applied,* the Secretary will publish a notice in the *Federal Register,* establishing cost limits and exploring the basis on which they were calculated.

44 Fed. Reg. 31802 (June 1, 1979) (emphasis added). The preamble accompanying the amendments stated that the Medicare Act authorizes the Secretary "to set *prospective limits* on the costs that are reimbursed under Medicare." *Id.* (emphasis added). Thus, plaintiffs assert, the Secretary's action violates not only the Medicare Act and the APA, but the principle of "prospectivity" required by the Secretary's own regulations.

Plaintiffs also point to the Secretary's administrative decisionmaking, in which "prospectivity" is emphasized:

> When an event occurs during the cost year that both changes a provider's eligibility for a new classification and significantly increases the provider's costs, a reclassification would not violate prospectivity. *The criteria for setting the limits and the limits themselves would be established for all categories prior to the cost reporting period.* The criteria and the limits would not change during that period. That is all that prospectivity requires under the circumstances in this case.

Beth Israel Hospital v. Blue Cross Association, CCH Medicare and Medicaid Guide ¶ 31,645 at 10,136-10,137 (Nov. 7, 1981) (emphasis added).

B.

In response, the Secretary generally seeks to characterize the November 26, 1984 action as a simple reissuance of the 1981 schedule after correction of the procedural defects that initially prevented effectuation. The Secretary stresses that the Court's decision in *DCHA* did not preclude re-issuance of the wage index rule, and that retroactive effect is accorded rules when it is reasonable and in the public interest to do so. *See SEC v. Chenery Corp.,* 332 U.S. 194 (1947). The Secretary argues that the reissued wage index rule will more accurately reflect actual costs, and that to deny the reissued rule retroactive effect will permit plaintiffs to retain an unjustified "windfall."

The Secretary quotes this Court's statement that " '[i]t is both logical and precedented that an agency can engage in new rulemaking to correct a prior rule which a court has found defective.' " *Community Hospital of Battle Creek v. Heckler,* No. 84-0743, slip op. at 6 (D.D.C. Oct. 30, 1984), *quoting NAACP v. Donovan,* 737 F.2d 67, 72 (D.C. Cir. 1984).

Defendant contends that even if the reissued rule is perceived as a new rule, rather than a reissued "procedurally corrected" old rule, that retroactive application is justified after scrutiny of the *Retail Union* factors. The Secretary contends that the reissued rule does not constitute an "abrupt departure" from established practice as plaintiffs were forewarned by the issuance of the 1981 schedule that the Secretary intended to exclude federal hospital data from the wage index.

For the same reason, the Secretary argues that plaintiffs cannot reasonably claim to have relied to their detriment on the previous wage index. The Secretary notes that the 1981 schedule, although later invalidated, was in place before the cost reporting periods at issue and was not invalidated until April 29, 1983. Thus, the Secretary asserts, plaintiffs should have conducted their planning for the

relevant cost periods under the assumption that federal hospital data would be excluded.

Defendant contends that retroactive application will not unduly burden plaintiffs, as the wage index excluding federal hospital data more accurately reflects actual costs. Thus, the Secretary argues, rather than being unduly burdened by the retroactive application, plaintiffs are prevented from enjoying unjust enrichment.

As to the final *Retail Union* factor, defendant argues that his action furthers the statutory interest in reimbursing only those costs necessary in the efficient delivery of health services. The Secretary notes that 42 U.S.C. § 1395(x)(v)(1)(A)(ii) authorizes "suitable retroactive adjustments" when necessary to cure over- or under-reimbursement, and cites cases in which retroactive Medicare adjustments have been upheld. *See Fairfax Nursing Center, Inc. v. Califano,* 590 F.2d 1297 (4th Cir. 1979); *Adams Nursing Home of Williamstown, Inc. v. Mathews,* 548 F.2d 1077 (1st Cir. 1977); *Springdale Convalescent Center v. Mathews,* 545 F.2d 943 (5th Cir. 1977); *Hazelwood Chronic & Conv. Hosp. v. Weinberger,* 543 F.2d 703 (9th Cir. 1976).

On the merits of the reissued rule, the Secretary contends that the rule is substantively, as well as procedurally, valid. The Secretary quotes from the preamble to the 1981 notice:

> We concluded that the exclusion of Federal government hospital data would improve the accuracy of the wage index because most Federal hospitals characteristically employ physicians and other high salaried professionals whose salaries are based on national rather than local wage scales. This factor tends to overstate the average hospital wage in areas with Federal institutions as compared to areas without such Federal facilities. Since the purpose of the wage index is to reflect area-by-area differences in the labor-related component of hospital costs, the exclusion of Federal hospital data better enables the wage index to accurately reflect area-by-area labor-related costs.
>
> To the extent hospitals must pay employees wage rates similar to those of Federal facilities to attract qualified personnel, this competitive behavior is reflected in the non-Federal BLS data used to calculate the wage index. That is, if non-Federal hospitals in an area pay wage rates relatively equivalent with those of Federal hospitals, the exclusion of Federal wages would have little effect on the wage index. If wages paid to Federal hospital employees are higher than most area hospital wage levels, then the inclusion of Federal data results in most hospitals receiving a higher Medicare cost limit than is warranted based on their expected costs. Such a result defeats the purpose of the cost limits, which is to limit a provider's reimbursement to only those costs necessary in the efficient delivery of needed health services. Therefore, reissuance of the wage index excluding Federal hospital data reflects Congressional intent to limit hospital reimbursement to those costs necessary in the efficient delivery of services.

49 Fed. Reg. 6175, 6177 (February 17, 1984). While the Secretary does not dispute plaintiffs' claim that urban "core"/suburban "ring" differentiation might yield an even more accurate wage index, he contends that positive change may be accomplished piecemeal, and that core-ring differentiation requires more study before implementation.

The Secretary contends that many providers were benefitted by the wage index excluding federal hospital data, and that many comments received after the February 17,

1984 proposed notice favored implementation of the change. These providers, defendant asserts, would be substantially harmed by invalidation, as the fiscal intermediaries would be forced to open up past cost-reporting years and recoup funds reimbursed under the wage index excluding federal data.

Finally, the Secretary contends that plaintiffs could have applied for an exception under 42 C.F.R. § 405.460 (f)(8) from application of the wage index of which they complain. Section 405.460(f)(8) grants an exception to an individual hospital that can demonstrate that its percentage of labor costs varies by more than ten percent from the percentage used to calculate its area's limits. As plaintiffs did not apply for such exception, the Secretary suggests that they should not be heard to complain of application of the reissued wage index.

III.

Plaintiffs' motion for summary judgment is well taken. Under the circumstances of this case, the Secretary's reissued wage index is invalid insofar as it was retroactively applied to recoup monies paid to these plaintiffs under the wage index previously in force.

The fact that the November 26, 1984 wage index rule was retroactive cannot reasonably be denied. As plaintiffs correctly note, the effect of this Court's decision in *DCHA* was to render the 1981 schedule void *ab initio*, and to reinstate the previous wage index which included federal hospital data. The fiscal intermediaries recognized this when they settled plaintiffs' reimbursement for the cost years at issue using the wage index that included federal hospital data. The issues that are thus joined are (1) whether the Secretary was authorized to promulgate a rule with intended retroactive applications and (2) if so, whether retroactive application was justified in the circumstances of this case.

Addressing the first issue, it is not entirely clear that the Secretary is even *authorized* to apply a notice and comment cost-limit rule retroactively as was done in this case. Plaintiffs correctly note that the legislative history of § 223 of Pub. L. No. 96-603 indicates that limits set under § 223 are to be "exercised on a prospective, rather than retrospective, basis so that the provider would know in advance the limits to Government recognition of incurred costs and have the opportunity to act to avoid having costs that are not reimbursable." H.R. Rep. No. 92-231, *supra*, at 83; S. Rep. No. 92-1230, *supra*, at 188. Moreover, a "rule" under the APA is defined as "the whole or part of an agency statement of general or particular applicability and *future effect*," 5 U.S.C. § 551(4) (emphasis added), and our Court of Appeals has stated that rules adopted under APA notice and comment procedures "are prospective in application only." *Retail Union, supra*, 466 F.2d at 388. *See also Citizens, supra*, 600 F.2d at 880 (Supporting "the general principle that agency [notice and comment] rulemaking, whenever possible, should be prospective only in effect"). In addition, the Secretary's action does appear to violate 5 U.S.C. § 553(d)'s requirement that rules must have a thirty day delayed effective date. Finally, plaintiffs correctly note that the Secretary's own regulations, *see* 42 C.F.R. § 405.460(b)(3), and administrative decisionmaking stress the principle of *prospectivity* in cost limit pronouncement and application. *See Beth Israel Hospital, supra*, CCH Medicare and Medicaid Guide ¶ 31,645.

42 U.S.C. § 1395(x)(v)(1)(A)(ii), however, does authorize the Secretary to

> provide for the making of suitable retroactive corrective adjustments where, for a provider of services for any fiscal period, the aggregate reimbursement produced by the methods of determining costs proves to be either inadequate or excessive.

Defendant correctly notes that this provision has been interpreted to authorize retroactive application of rules and recoupment based on cost years prior to the single cost year that preceded the promulgation of the rule. *See Fairfax Nursing Center, supra; Adams Nursing Home of Williamstown, supra; Springdale Convalescent Center supra; Hazelwood Chronic & Conv. Hosp., supra.* The scope of section 1395(x)(v)(1)(A)(ii) is far from settled, however; the Court of Appeals for the 9th Circuit has examined the legislative history and concluded that Section 1395(x)(v)(1)(A)(ii) did not contemplate that reimbursement principles could be changed and recoupment conducted *after* a cost reporting year has been completed and the provider's claims settled. *See Daughters of Miriam Center for the Aged v. Mathews,* 590 F.2d 1250, 1258-59 n.23 (3d Cir. 1978), *quoting* Hearings before the Senate Committee on Finance, 89th Cong., 2d Sess. 119 (1966).

It is unnecessary, however, to rest summary judgment for plaintiffs on the ground that the Secretary was not *empowered* to apply the reissued wage index rule retroactively to the cost years in question. Our Court of Appeals has stated with regard to the balancing of factors in evaluation of retroactive rulemaking:

> Which side of the balance preponderates is in each case a question of law, resolvable by reviewing courts with no overriding obligation of deference to the agency decision. [Citation omitted.]

Retail Union, supra, 466 F.2d at 390.

The *Retail Union* factors have been applied to determine the validity of retroactively applied "notice and comment" rules. *See Citizens, supra,* 600 F.2d at 881 n.185. Examination of those factors in this case compels the conclusion that the re-issued wage index must be invalidated insofar as it was applied retroactively to recoup monies reimbursed to these plaintiffs under the wage index that included federal hospital data.

The first *Retail Union* factor to be considered is whether a case is of "first impression." This is important because:

> to deny the benefits of a change in the law to the very parties whose efforts were largely responsible for bringing it about might have adverse effects on the incentive of litigants to advance new theories or to challenge outworn doctrines.

Retail Union, supra, 466 F.2d at 390. This general policy weighs strongly against permitting the Secretary to take the course upon which he has embarked in this case. It would stand the APA on its head and dramatically discourage litigants from contesting procedural deficiencies if the Secretary could, after invalidation of a rule, simply engage in *pro forma* procedural corrections and retroactively reissue the rule against those who challenged it initially.

The second *Retail Union* factor relates to whether the new rule is an abrupt departure from the pre-existing ones. The November 26, 1984 notice and its retroactive application dramatically departed from prior practice. This Court's decision in *DCHA* reinstated the wage index that included federal hospital data, and as late as July 10, 1984, the Secretary indicated in open Court that the Secretary had no present intention of recouping the monies reimbursed to plaintiffs under the pre-existing wage index, and future recoupment strategies were uncertain. *See* Administrative Record at 177. Under these circumstances, the retroactive application of the rule issued November 26, 1984 may fairly be described as an "abrupt departure."

The third *Retail Union* factor relates to whether the party against whom the new rule is applied relied on the old rule. While plaintiffs had perhaps been forewarned by the 1981 schedule of the Secretary's views on inclusion in the wage index of federal hospital data, this Court's *DCHA* opinion and the Secretary's representations on July 10,

1984 were sufficient that plaintiffs justifiably expected to retain the funds reimbursed to them after *DCHA* by fiscal intermediaries applying the wage index rule that included federal data.

The fourth *Retail Union* factor concerns the degree of the burden which a retroactive order imposes on a party. It cannot be disputed that the retroactive application substantially burdens plaintiffs. The Secretary does not contest plaintiffs' claims that over $1,400,000 has been recouped from them by fiscal intermediaries applying the retroactive rule.

Most significant, however, is the final *Retail Union* factor: whether any statutory interest supports retroactive application of the new rule so as to justify recoupment from these plaintiffs. The Secretary has not traversed plaintiffs' demonstration, employing BLS data, that the failure to differentiate between "core" and "ring" hospitals—coupled with the exclusion of federal hospital data—resulted in a wage index that *less* accurately reflected their costs than did the wage index which included federal hospital data. Accordingly, application of the reissued wage index rule to these plaintiffs would have resulted in under-reimbursement of legitimate costs—which would contravene the purposes of the Medicare statutes. The Secretary's argument that recoupment is necessary to prevent "unjust enrichment" is without foundation; plaintiffs represent without contradiction that they are not-for-profit hospitals and that their reimbursements were restricted to the lesser of *actual costs* or cost limits. Under such circumstances, plaintiffs can hardly be said to be "unjustly enriched" by invalidation of the Secretary's retroactive recoupment measures.

The Secretary's passing reference[1] to section 2316 of the

[1] *See* Memorandum of Points and Authorities in Support of Defendant's Motion for Summary Judgment at 18 n.15 (filed October 21, 1985). The Secretary actually referenced § 2311; it is assumed that he intended to refer to § 2316.

Deficit Reduction Act of 1984, Pub. L. No. 98-369, 98 Stat. 1081 (1984), is not persuasive that a different result is required. Section 2316, enacted in the middle of the cost year beginning October 1, 1983, contemplated formulation of an improved wage index applicable to health care providers under the prospective payment plan. The section further contemplated that upon formulation of the improved wage index, adjustments would be made to payment amounts to providers for the cost year *during which* the required revised index was prepared. Such adjustments were to be made by decreasing or increasing payments in the succeeding cost period. Consequently, section 2316 does not strongly support the Secretary's action in 1984 in opening up for recoupment 1981 and 1982 cost years that have already been settled and expired several years before the retroactive wage index rule was promulgated. The fact that the Secretary first noticed in 1981 his intention to exclude federal hospital data from the wage index does not render the adjustment principles of section 2316 applicable in this case. The Secretary's 1981 schedule was rendered void *ab initio* and without effect by this Court's *DCHA* opinion. Thus, the 1984 retroactive wage index, unlike the revised prospective payment plan wage index contemplated by section 2316, reached back to cost years that expired several years prior to its issuance. Even more significantly, § 2316 by its terms justifies such payment adjustments by reference to the very problem which the Secretary has in this case failed to confront with sufficient particularity: the effect of area differentials and *relevant* labor markets on average hospital wage levels. These critical underlying principles render inapposite the Secretary's citation of section 2316 in support of his action in this case.

The Secretary's actions after *DHCA* suggest, as plaintiffs intimate, that the Secretary has trivialized the APA. Plaintiffs represent without contradiction that no com-

ments expressed favor for retroactive recoupment from those providers who had used the wage index including federal hospital data. Indeed, the February 1984 notice included no clear indication that the Secretary intended to apply the measure retroactively so as to effect such a recoupment. Such action in the face of comments opposed to it suggests that the notice and comment "procedural correction" was in critical respects simply *pro forma*. Such is the stuff of which arbitrary and capricious decisions are made.

The Supreme Court has clarified the general principles to be applied in determining whether new pronouncements should be given retroactive application:

> [R]etroactivity must be balanced against the mischief of producing a result which is contrary to a statutory design or to legal and equitable principles. If that mischief is greater than the ill effect of the retroactive application of a new standard, it is not the type of retroactivity which is condemned by law.

SEC v. Chenery Corp., supra, at 203. Conversely, if the ill effect of retroactive application exceeds any "mischief" to the statutory design that would result from denying retroactive application, there should be no retroactive application. As has been demonstrated, *see supra* pp. 18-21, the balancing of factors in this case compels the conclusion that Medicare statute interests are only minimally served, if at all, by the Secretary's retroactive application of his reissued wage index to recoup funds from these plaintiffs. In contrast, the ill effects of the Secretary's action are substantial for these plaintiffs and for the general integrity of the administrative rule-making process. Accordingly, retroactive application against these plaintiffs must be denied.

This ruling does not overlook defendant's expressed concern that the ruling requires the Secretary to open up

and recoup funds reimbursed to providers who used the wage index that *excluded* federal hospital data. This concern is unwarranted. It may well be that the wage index excluding federal hospital data operates to the advantage of and better reflects costs for non-federal hospitals in suburban portions of SMSA's. Regulations and case law provide ample precedent for the Secretary to determine that a rule would not serve the statutory interests if applied in certain circumstances. For example, 42 C.F.R. § 405.460(f)(8), while not—as defendant contends—precluding plaintiffs from presenting other challenges,[2] does support the principle that the Secretary need not treat all individual hospitals under the same wage index rule when it would contravene statutory purposes to do so. *See also Regents of the University of California v. Heckler,* 756 F.2d 1387, 1397 (9th Cir. 1985):

> the Secretary must afford claimants the opportunity to demonstrate that the application of a particular rule to the facts of their case would produce a result that is contrary to the statutory mandate.

Moreover, "[w]here any administrative rule, although considered generally to be in the public interest, is not in the public interest as applied to particular facts, an agency should waive application of the rule." *P&R Temmer v. FCC,* 743 F.2d 918, 929 (D.C. Cir. 1984); *accord American Farm Lines v. Black Ball Freight Service,* 397 U.S. 532, 539 (1970). Thus, there is nothing in this ruling which requires the Secretary to recoup from those who have used a wage index which excluded federal hospital data.

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[2] Defendant does not persuasively traverse plaintiffs' demonstration that § 405.406(f)(8) would not have been available to them and that any relief accorded under that section would have been *de minimis*.

For all of the above reasons, the accompanying order will grant plaintiffs' motion for summary judgment, deny defendant's motion for summary judgment and declare the reissued wage index rule invalid insofar as it was applied to recoup monies from these plaintiffs. Defendant will be required to reimburse plaintiffs with interest for those funds recouped under retroactive application of the November 26, 1984 wage index.

/s/ LOUIS F. OBERDORFER
United States District Judge

Date: April 11, 1986

UNITED STATES DISTRICT COURT
FOR THE DISTRICT OF COLUMBIA

Civil Action No. 85-1845

GEORGETOWN UNIVERSITY HOSPITAL, ET AL., PLAINTIFFS

v.

OTIS R. BOWEN,* SECRETARY OF THE DEPARTMENT OF HEALTH AND HUMAN SERVICES, DEFENDANT

Civil Action No. 85-2545

HOWARD UNIVERSITY
AS HOWARD UNIVERSITY HOSPITAL, ET AL., PLAINTIFFS

v.

OTIS R. BOWEN,* SECRETARY OF THE DEPARTMENT OF HEALTH AND HUMAN SERVICES, DEFENDANT

Civil Action No. 85-2862

TUSCON GENERAL HOSPITAL, PLAINTIFF

v.

OTIS R. BOWEN,* SECRETARY OF THE DEPARTMENT OF HEALTH AND HUMAN SERVICES, DEFENDANT

[Filed Apr. 11, 1986]

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* Otis R. Bowen is substituted for Margaret M. Heckler pursuant to Fed. R. Civ. P. 25(d).

ORDER

For the reasons stated in an accompanying Memorandum, it is this 11th day of April, 1986, hereby

ORDERED: that plaintiffs' motion for summary judgment should be, and it hereby is, GRANTED; and it is further

ORDERED: that defendant's motion for summary judgment should be, and it hereby is, DENIED; and it is further

DECLARED: that the retroactive wage index rule published at 49 Fed. Reg. 46495 *et seq*. (November 26, 1984), was and is invalid insofar as it was applied to recoup funds previously reimbursed to plaintiffs; and it is further

ORDERED: that, on or before April 25, 1986, defendant pay to the plaintiffs all amounts previously recouped from the plaintiffs based on defendant's retroactive wage index rule (including any interest charged by defendant during the recoupment process), plus interest (computed to the date of payment) in accordance with 42 U.S.C. § [illegible](f)(2).

/s/ LOUIS F. OBERDORFER
United States District Judge

APPENDIX C

UNITED STATES COURT OF APPEALS
FOR THE DISTRICT OF COLUMBIA CIRCUIT

No. 86-5381
Civil Action No. 85-1845

GEORGETOWN UNIVERSITY HOSPITAL, ET AL.

v.

OTIS R. BOWEN, SECRETARY OF HEALTH AND HUMAN SERVICES, APPELLANT

No. 86-5382
Civil Action No. 85-2545

HOWARD UNIVERSITY
AS HOWARD UNIVERSITY HOSPITAL, ET AL.

v.

OTIS R. BOWEN, SECRETARY OF HEALTH AND HUMAN SERVICES, APPELLANT

No. 86-5383
Civil Action No. 85-2862

TUSCON GENERAL HOSPITAL

v.

OTIS R. BOWEN, SECRETARY OF HEALTH AND HUMAN SERVICES, APPELLANT

Appeals from the United States District Court
for the District of Columbia

[Filed June 26, 1987]

JUDGMENT

Before: EDWARDS and STARR, *Circuit Judges,* and SWYGERT, **Senior Circuit Judge,* United States Court of Appeals for the Seventh Circuit.

These causes came on to be heard on the records on appeal from the United States District Court for the District of Columbia, and were argued by counsel. On consideration thereof, it is

ORDERED and ADJUDGED, by this Court, that the judgment of the District Court appealed from in these causes is hereby affirmed, in accordance with the Opinion for the Court filed herein this date.

Date: June 26, 1987
Opinion for the Court filed by Circuit Judge Edwards.

* Sitting by designation pursuant to 28 U.S.C. § 294(d)(1982).

APPENDIX D

UNITED STATES COURT OF APPEALS
FOR THE DISTRICT OF COLUMBIA CIRCUIT

No. 86-5381

GEORGETOWN UNIVERSITY HOSPITAL, ET AL.

v.

OTIS R. BOWEN, SECRETARY OF HEALTH AND HUMAN SERVICES, APPELLANT

[Filed Sept. 1, 1987]

ORDER

Before: EDWARDS and STARR, *Circuit Judges,* and SWYGERT,* *Senior Circuit Judge,* United States Court of Appeals for the Seventh Circuit.

We have considered appellant's petition for rehearing in the above-captioned case. Appellant characterizes our opinion as holding that the Administrative Procedure Act imposes a "per se" ban on retroactive rulemaking. As a general rule, the APA requires that legislative rules be given future effect only. Whatever exceptions might exist to this general rule were not implicated in the case before us. Our opinion therefore does not purport to address circumstances in which there may be an exception to the rule against retroactive rulemaking.

It is therefore ORDERED, by the Court, that the petition for rehearing is denied.

* Sitting by designation pursuant to 28 U.S.C. Section 294(d).

Per Curiam
FOR THE COURT:
GEORGE A. FISHER, Clerk

/s/ ROBERT A. BONNER
By: Robert A. Bonner
Deputy Clerk

APPENDIX E

UNITED STATES COURT OF APPEALS FOR THE DISTRICT OF COLUMBIA CIRCUIT

No. 86-5381

GEORGETOWN UNIVERSITY HOSPITAL, ET AL.

v.

OTIS R. BOWEN, SECRETARY OF HEALTH AND HUMAN SERVICES, APPELLANT

[Filed Sept. 1, 1987]

ORDER

Before: WALD, *Chief Judge,* and ROBINSON, MIKVA, EDWARDS, RUTH B. GINSBURG, BORK, STARR, SILBERMAN, BUCKLEY, WILLIAMS, and D.H. GINSBURG, *Circuit Judges,* and SWYGERT,* *Senior Circuit Judge,* United States Court of Appeals for the Seventh Circuit.

Appellant's suggestion for rehearing *en banc* has been circulated to the full Court. No member of the Court requested the taking of a vote thereon. Upon consideration of the foregoing, it is

ORDERED, by the Court *en banc,* that the suggestion is denied.

* Sitting by designation pursuant to 28 U.S.C. Section 294(d).

Per Curiam
FOR THE COURT:
GEORGE A. FISHER, Clerk

/s/ ROBERT A. BONNER
By: Robert A. Bonner
Deputy Clerk

APPENDIX F

UNITED STATES DISTRICT COURT
FOR THE DISTRICT OF COLUMBIA

Civil Action No. 82-2520

DISTRICT OF COLUMBIA
HOSPITAL ASSOCIATION, ET AL., PLAINTIFFS

v.

MARGARET HECKLER, ET AL., DEFENDANTS

[Filed Apr. 29, 1983]

MEMORANDUM

I

For each of the even years before 1981, defendants have published an annual schedule of limits on hospital costs reimbursable under the Medicare Act only after publishing a notice of proposed rulemaking and receiving comments solicited by that notice, pursuant to the Administrative Procedure Act ("APA"), 5 U.S.C. § 553. On June 30, 1981, however, defendants published a "Final Notice" of the 1981 "Schedule of Limits on Hospital . . . Costs," 46 Fed. Reg. 33637 (June 30, 1981), without first publishing a proposed rule and receiving comments, despite the fact that the new 1981 schedule for the first time excluded the wages paid by "federal government hospitals" in each market area from the formula used to calculate reimbursable wage costs for that area. *See id.* at 33639.

In the 1981 Final Notice, defendants noted that because of this exclusion of federal wage data, the wage index for the 1981 cost limit schedule "differs . . . from the wage

index used in developing the 1980 hospital cost limits." *Id.* at 33638. The defendants explained their decision to exclude the data as follows:

> "Because these [federal government] hospitals typically use national pay scales, the amounts they pay their employees do not necessarily reflect area wage levels. We believe excluding data from these hospitals will help improve the accuracy of the wage index adjustment."

Id. at 33639. Defendants stated that this was a "minor technical change[ ]." *Id.* at 33638. They also stated, in justification of foregoing notice and comment, that it "would be contrary to the public interest to permit" 1980 cost limits to remain in effect any longer, *id.* at 33640, presumably, although the notice did not so indicate, because the 1980 limits led to higher hospital reimbursements and greater expense to the Medicare program.

Plaintiffs are three "not-for-profit" hospitals located in the District of Columbia and an association representing the interests of 15 similar hospitals in the District of Columbia. Apparently, neither the individual hospital plaintiffs nor the 15 hospitals represented by the association are "federal government hospitals." [1] There are, however, a relatively large number of federal government hospitals in the District of Columbia market area. Plaintiffs allege that they have been substantively damaged in two ways by the decision to exclude federal hospital wage data from the wage index for the 1981 Medicare hospital cost limits schedule. First, the new limit substantially reduces the

[1] All the plaintiff hospitals and "nearly all" of the association's member hospitals provide services under the Medicare and Medicaid programs. Complaint, ¶¶ 7, 11. As defendants note, with exceptions under one treatment program "[f]ederal government hospitals do not participate in Medicare." Defendants' Post-Hearing Memorandum (March 21, 1983) at 3, n.2.

income derived by plaintiffs from the Medicare program on account of services provided to Medicare patients.[2] Second, this decrease in reimbursement payments also allegedly reduces plaintiffs' ability to compete in hiring qualified personnel against the higher-paying federal hospitals in the area.

Plaintiffs' basis for suit, however, does not rest on their alleged monetary injuries or the substance of defendants' decision to exclude federal wage data from the 1981 wage index. Their challenge is solely procedural. Plaintiffs claim that defendants' failure to carry out notice and comment procedures before deciding to eliminate federal hospital wage data from the 1981 schedule violated the APA, 5 U.S.C. § 551 *et seq.* They therefore seek a declaratory judgment to this effect. They seek as further relief on this procedural claim an order vacating the 1981 cost limit schedule, enjoining defendants from excluding the federal hospital wage data from the calculation of reimbursements under the 1981 schedule, and requiring that any subsequent schedule that may be validly adopted after notice and comment be given prospective effect only. This prayer for relief will be dealt with below, separately from the procedural basis for the suit.

[2] According to plaintiffs, Children's Hospital Medical Center, Georgetown University Hospital and Greater Southeast Community Hospital "will incur" Medicare and Medicaid losses of $91,200, $278,100 and $423,000 respectively, "[s]olely as a result of the exclusion of the federal government hospital wage data from the wage index. . . ." Memorandum in Support of Plaintiffs' Motion for Summary Judgment (Oct. 7, 1982) at 7. Defendants argue that plaintiff hospitals can have no "expectation" or "reliance interest" in a particular level of reimbursement, so that these monetary allegations are improper. This may be true, but it is beside the point. Defendants do not contest the fact that, if federal wage data were included in the 1981 wage index, plaintiffs' reimbursement levels would be higher to some degree than if that data is excluded.

Defendants have moved to dismiss or in the alternative for summary judgment. They argue that this Court is without jurisdiction to review the decision by the Secretary of Health and Human Services to issue a final regulation without notice and comment, citing 42 U.S.C. § 405(h) (incorporated into the Medicare Act by 42 U.S.C. § 1395ii) and 42 U.S.C. § 1395oo (1976 & Supp. IV 1980).[3] Defendants further argue that, in any event, the Secretary had good cause to waive notice and comment for the 1981 schedule because exclusion of federal wage data was "a technical change" for which notice and comment procedures would have been "unnecessary and contrary to the public interest."[4] *See* Defendants' Supplementary Memorandum (Jan. 25, 1983) at 2-4.

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[3] Section 205(h) of the Social Security Act, 42 U.S.C. § 405(h), provides that:

> The findings and decisions of the Secretary after a hearing shall be binding upon all individuals who were parties to such hearings. No findings of fact or decision of the Secretary shall be reviewed by any person, tribunal, or government agency except as herein provided. No action against the United States, the Secretary, or any officer or employee thereof shall be brought under sections 1331 or 1346 of title 28 to recover on any claim arising under this subchapter.

42 U.S.C. § 1395oo, which will not be set forth here, sets up at length an administrative review mechanism for Medicare claims that may lead to judicial review once the mechanism has been exhausted. Plaintiffs have not attempted to initiate administrative proceedings under § 1395oo.

[4] Defendants do not argue that the annual cost limit schedule is not a "rule" subject generally to APA notice and comment requirements. Rather, they argue that *this particular change* (exclusion of federal wage data) was exempt under § 553(b)(B), which permits waiver of the rulemaking requirement for "good cause." Thus it is unnecessary to address plaintiffs' argument, which defendants do not controvert, that the 1981 change was otherwise subject to APA rulemaking procedures. It is conceded that such is the case. *See* Plaintiffs Memorandum in Support (Oct. 7, 1982) at 7-13; *see also Batterton v. Marshall*, 648 F.2d 694 (D.C. Cir. 1980).

In support of the latter argument defendants cite 5 U.S.C. § 553(b)(B), which provides for an exemption to the APA's notice and comment requirements "when the agency for good cause finds (and incorporates the finding and a brief statement of reasons therefor in the rules issued) that notice and public procedure thereon are impracticable, unnecessary, or contrary to the public interest."[5] According to defendants' Final Notice, although federal wage data was excluded for the first time in 1981, the Secretary used the "same methodology" to compute the 1981 wage index as had been used in earlier years. 46 Fed. Reg. 33638, 33640. Subsequently, defendants have characterized the exclusion of federal government hospital wage data as a "change in methodology," but one that was "minor and technical," so that notice and comment were "unnecessary" for purposes of the APA. Defendants' Memorandum of Points and Authorities (Nov. 22, 1982) at 17 (hereinafter "Points and Authorities"). At the same time, defendants urge that action without notice and comment served the public interest by protecting the public against payment of large "windfalls" to plaintiffs and other Medicare providers totalling "hundreds of thousands of dollars." Defendants' Supplementary Memorandum, *supra,* at 10; *see* Defendants' Points and Authorities, *supra,* at 25.

II

Jurisdiction is the threshold question. Our Court of Appeals has generally construed Section 205(h) of the Social Security Act (*see* note 3, *supra*) to bar federal court jurisdiction over claims seeking Medicare reimbursement.

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[5] Defendants do not argue that public participation was "impracticable" in this case. That obviously would be a difficult claim to sustain when defendants have previously used the notice and comment procedure in fixing these schedules for seven years.

Ass'n. of American Medical Colleges v. Califano, 569 F.2d 101 (D.C. Cir. 1977). Moreover, the detailed administrative review process for Medicare claims set out in 42 U.S.C. § 1395oo (*see* note 3, *supra*) generally must be exhausted before a claimant may seek review in federal court. *Id., see also Humana of South Carolina, Inc. v. Califano,* 590 F.2d 1070, 1080 (D.C. Cir. 1978). On the other hand, exhaustion is not required under these provisions and judicial review may lie *ab initio* (albeit with deference) when a lawsuit is brought "simply to vindicate an interest in procedural regularity." *Humana, supra,* 590 F.2d at 1080; *accord, National Ass'n. of Home Health Agencies v. Schweiker,* 690 F.2d 932, 936-37 (D.C. Cir. 1982), *cert. den.,* 103 S. Ct. 1193 (1983) (hereinafter "*NAHHA*").

Each party here struggles to fit the circumstances and precedents into categories advantageous to it. Plaintiffs emphasize that they make no monetary claims; they wish only to correct a violation of a fundamental requirement of the APA and seek a declaratory judgment by the Court on that theory. Defendants point to plaintiffs' additional prayers for injunctive relief barring defendants from applying to plaintiffs any wage schedule or wage schedule methodology different from that in effect in 1980, or from applying any new, procedurally valid, schedule retroactively. Defendants argue that this prayer for relief demonstrates that plaintiffs' only real interest is in the bottom line—a larger reimbursement when and if plaintiffs file their claims.

This is plainly not an "action brought to recover on any claim" within the specific terms of § 405(h). There has been no claim of which the Court is aware. Plaintiffs disavow any substantive challenge to the Secretary's wage index decision in this lawsuit, but rather claim the right under the APA to present their views to the Secretary for consideration in rulemaking. Plaintiffs' Memorandum in

Opposition (Dec. 20, 1982) at 2. Thus it is clear that this is not a dispute "over the amount properly reimbursable," and therefore that relief under § 1395oo is not available nor is its pursuit required for jurisdiction here. *See NAHHA, supra,* 690 F.2d at 938-39; *Humana, supra,* 590 F.2d at 1080-81.

Plaintiffs have, of course, criticized the substantive rationality of defendants' decision to exclude federal hospital wage data from the relevant formula. As a matter of policy, they disagree with that decision. But as a matter of law, they make this argument only to show how the omission of notice and comment proceedings deprived them of an opportunity to apprise the Secretary on the rulemaking record of relevant facts and considerations that might have led the defendants to a different result, or at least subsequently permitted the plaintiffs to argue to a reviewing court that the result the Secretary reached was irrational. Thus the claim pressed here by plaintiffs is essentially that of a party "aggrieved" by a rulemaking consummated without notice and comment. It is a claim made available under the APA to any person aggrieved by administrative action. Hopes of increased reimbursement may underlie plaintiffs' pursuit of an opportunity to comment to the Secretary about the change and may be, in that sense, plaintiffs' "motivation for bringing this lawsuit." *NAHHA, supra,* 690 F.2d at 938. But the point of law at issue is vindication of their statutory rights to have notice of and to comment on administrative decisions that affect them. Those rights have values of their own, independent of any claim for reimbursement: "increased fairness" to affected parties, and provision to the Secretary of "valuable information concerning the various issues involved." *NAHHA, supra,* 690 F.2d at 950; *see also Small Refiner Lead Phase-Down Task Force v. U.S. Environmental Protection Agency,* No. 82-2282, slip op. at 85 (April 22, 1982). Plaintiffs are entitled to judicial con-

sideration of their challenge to possible denial of these values, irrespective of whether favorable resolution would ultimately support a separate administrative claim for reimbursement, or not.[6]

Defendants appear to suggest that whenever a monetary interest can be traced to the plaintiffs in a Medicare case, there can be no immediate federal jurisdiction. Defendants' Points and Authorities, *supra,* at 14-15. This is a strained and unrealistic interpretation of the statutes and relevant precedent. In both *Humana* and *NAHHA,* it was clear that plaintiffs challenging particular decisions of the Secretary on procedural grounds were doing so because of the ultimate fiscal impact which those decisions might or would have on them. Indeed, the sort of injury necessary for standing in a federal court is unlikely to ever be entirely separated from monetary interests in a Medicare case. Congress's intention to prevent judicial interference with the Secretary's substantive decisionmaking concerning particular monetary claims in the Medicare program can and must be reconciled with its intention in passing the APA to permit those regulated by unelected federal agencies to receive some procedural process prior to exercise of the regulatory power. That end is accomplished by finding immediate federal jurisdiction over procedural claims while barring such jurisdiction over substantive monetary challenges. Thus our Court of Appeals in *NAHHA* distinguished between a plaintiff's "ultimate goal" and his "motivation," and indicated that only claims "*directly*

[6] Although it is not the basis for the Court's decision, defendants themselves have, as already noted, characterized the change that plaintiffs challenge as one in "methodology." Our Court of Appeals has suggested that substantive challenges to the "method" of determining claims, as opposed to the "amount" of such claims, may be heard by courts in the first instance. *NAHHA, supra,* 690 F.2d at 938; *see Riverside General Hospital v. Schweiker,* 548 F. Supp. 1137, 1141-42 (D.D.C. 1982).

related to a claim for reimbursement" can and must be reviewed under § 1395oo. 690 F.2d at 938 (emphasis supplied). When such alternate forms of judicial review are unavailable as in a procedural case like this one, the law in this Circuit is that § 405(h) does not preclude federal jurisdiction over federal claims. *Id.* at 940-41. The legal rights normally provided under the APA cannot be cut off by the language of § 405(a) or § 1395oo unless expressly indicated by Congress, and the Court is aware of no such express indication.

This conclusion is not altered by consideration of the 1980 amendment to § 1395oo that specifically authorized expedited judicial review of "a question of law and regulations" where the Medicare administrative review board "determines that it is without authority to decide the question." 1980 Omnibus Budget Reconciliation Act, Pub. L. No. 96-499, § 955, 94 Stat. 2599, 2647 (1980). This argument was made by the Secretary and rejected by our Court of Appeals in *NAHHA, supra.* The Court of Appeals ruled there that the 1980 amendment was directed only at claims "otherwise reviewable under the statute." 690 F.2d at 939. Here, as there, plaintiffs' claim is a procedural one not cognizable under the statute, and it "cannot be characterized as a reimbursement dispute." *Id.*[7] Accordingly,

[7] Moreover, the Secretary has already made the decision to forego notice and comment for the 1981 schedule; that decision has been considered, reaffirmed and defended in this proceeding. The Secretary's decision to forego notice and comment must be considered on the grounds offered at the time of the decision, i.e., the grounds that appear at 46 Fed. Reg. 33637-44 (June 30, 1981). *S.E.C. v. Chenery Corp.,* 332 U.S. 194, 196 (1947); *Portland Cement Association v. Ruckelhaus,* 486 F.2d 375, 395 (D.C. Cir. 1973) (Leventhal, J.), *cert. den.,* 417 U.S. 921 (1974); *cf. Lanphear v. Prokop,* No. 82-1388, slip op. at 11 (D.C. Cir. April 1, 1983). Thus it would be an exercise in futility to decline jurisdiction over the notice and comment issue now, only to have to consider it again on these same grounds after it has gone through the administrative mill.

defendants' motion to dismiss for lack of jurisdiction will be denied.

III

There remains for consideration defendants' contention that the exclusion of federal hospital wages was a "minor technical change" which was exempt from notice and comment under the "good cause" exemption of the APA. 5 U.S.C. § 553(b)(B). The "good cause" exemption relied upon by defendants does not operate upon mere incantation, as defendants appear to suggest, *see* Supplementary Memorandum, *supra,* at 2-3, and a court cannot accept an agency's finding of "unnecessary" on faith alone. The exemption of § 553(b)(B) is to be "narrowly construed" and reviewing courts should "examine closely proferred rationales justifying the elimination of public procedures." *A.F.G.E. v. Block,* 655 F.2d 1153, 1157 n.6 (D.C. Cir. 1981); *see Council of Southern Mountains, Inc. v. Donovan,* 653 F.2d 573, 580 (D.C. Cir. 1981).

The argument that public participation was "unnecessary" does not survive even deferential scrutiny. When Congress enacted § 555(b)(B), it explained that

> " '[u]nnecessary' means unnecessary *so far as the public is concerned,* as would be the case if a minor or merely technical amendment *in which the public is not particularly interested* were involved."

S. Rep. No. 752, 79th Cong., 1st Sess., at 16 (1945), reprinted in *Administrative Procedure Act—Legislative History* 200 (U.S. Gov't. Printing Office 1946) (emphasis supplied). " '[P]ublic interest' supplements the terms 'impracticable' and 'unnecessary,' " and only "lack of public interest in rulemaking warrants an agency to dispense with public procedure." *Id.* Thus it is the *public's* perception of a rule change, and not the agency's, that must govern. The institution of this lawsuit, as well as the conceded fact that

"hundreds of thousands of dollars" are at issue, indicate that at least a portion of the public is very interested in defendants' decision, and would have taken advantage of the opportunity to comment if it had been afforded.

Moreover, defendants are caught in contradiction when they leap from a description of the wage index change as "minor" to their argument that notice and comment would have been "contrary to the public interest." Defendants argue that the change in the formula was so insignificant that it produced only a "very limited . . . small impact." Points and Authorities, *supra,* at 21-22. Yet they also argue that the public interest justified acting without awaiting public participation because the new schedule would save the public money and protect against "windfalls" totalling "hundreds of thousands of dollars." This contradictory rationale is the stuff of which arbitrary and capricious decisions are made.

Defendants' assertion that public participation in developing the 1981 wage index was "unnecessary" or "contrary to the public interest" overlooks the fact that plaintiffs and the public had no opportunity to provide information about the potential impact of the exclusion. The decision was clearly a controversial one, and plaintiffs have demonstrated that the Secretary may have been unaware or even mistaken about some facts central to the decision.[8] Defendants' description of the possibility of increased payments to plaintiffs as "windfalls" thus begs the very question that proper notice and comment procedures could have addressed and resolved.

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[8] For example, the defendants did not have a list before them of all federal government hospitals when deciding to exclude their wage data, thus making precise calculation of the fiscal impact difficult. *See* Plaintiffs' Second Supplemental Memorandum (March 1, 1983) at 2. Defendants may have also erred in their assumption that federal govenment hospitals "typically" set their wages according to "national pay scales." *Id.* at 2-3. *See also* Plaintiffs' Memorandum in Support (Oct. 7, 1982) at 16-20.

Moreover, the administrative agencies that determine provider reimbursement claims are now bound by the Secretary's decision to exclude federal wage data. The decision thus made law, binding on the agency which administered it, without even the limited process that notice and comment would have afforded. *See Batterton v. Marshall,* 648 F.2d 694 (D.C. Cir. 1980); *Joseph v. U.S. Civil Service Commission,* 554 F.2d 1140, 1157 (D.C. Cir. 1977).

On the basis of the foregoing and other badges of arbitrariness and caprice identified by plaintiffs in their memoranda, the Secretary's decision to exempt the exclusion decision from notice and comment must be declared unlawful. Consequently, with regard to the exclusion of federal wage data that plaintiffs challenge, the 1981 schedule was, and is, invalid.

IV

The question of remedy remains, and presents a more difficult problem. Defendants urge that even if the federal wage data exclusion decision was invalid for lack of public participation required by the APA, the 1981 wage index and schedule should remain in effect as promulgated unless and until a new index is properly promulgated utilizing notice and comment. Such a result would be contrary to the normal remedy in an APA case. Our Court of Appeals has noted that "[n]ormally, a judicial determination of procedural defect requires invalidation of the challenged rule." *Batterton, supra,* 648 F.2d at 711. The APA itself states that a "reviewing court *shall* . . . hold unlawful *and set aside* agency action . . . found to be . . . without observance of procedure required by law." 5 U.S.C. § 706(2)(D) (emphasis supplied). *See also Chrysler Corp. v. Brown,* 441 U.S. 281, 313 (1979).

On occasion courts have exercised their equitable discretion to keep procedurally invalid regulations in place for a

short time until new regulations could be properly promulgated. *See, e.g., Rodway v. U.S. Dept. of Agriculture,* 514 F.2d 809, 817-18 (D.C. Cir. 1975); *U.S. Steel Corp. v. E.P.A.,* 649 F.2d 572, 577 (8th Cir. 1981); *Western Oil & Gas Ass'n. v. E.P.A.,* 633 F.2d 803, 813 (9th Cir. 1980). These cases and others that defendants cite, however, were characterized by factors counselling in favor of maintaining invalid regulations that are *not* present here: emergency situations or wholesale disruption of critical government programs, and lack of a prior regulatory scheme to operate to in place of the invalid regulations. *See Rodway, supra,* at 817 (food stamp regulations of "critical importance" affecting "over ten million American families"); *A.F.G.E. v. Block, supra,* 655 F.2d at 1157 ("emergency regulations" had been required by prior court order); *Asarco, Inc. v. O.S.H.A.,* 647 F.2d 1, 2-3 (9th Cir. 1981) (per curiam) (arsenic exposure standard where exposure poses "serious health risk"); *Western Oil & Gas, supra,* 633 F.2d at 813 (Clean Air Act regulations for entire state of California); *U.S. Steel, supra,* 649 F.2d at 577 (same for Minnesota).

In this case, invalidation of the 1981 wage index and formula would leave in place the formula that was arrived at after proper notice and comment procedures and was used successfully to reimburse providers prior to July 1981. The only difference would be that federal wage data would be included in the index. Invaliding the 1981 wage index therefore would not substantially disrupt defendants' administration of the Medicare program. And the equities do not weigh as clearly in defendants' favor as defendants suggest. As noted above, defendants' characterization of higher payments to plaintiffs as "windfalls" or "unjust enrichment" begs the question and frustrates the purpose of notice and comment. Likewise, the argument that invalidation would "thwart the operation of the law" begs the question of what the law requires: the inclusion of

federal wage data does not violate any express statement of the Medicare law as it appears in the statutes, whereas defendants' conduct in promulgating the 1981 schedule clearly violated the APA.

Therefore, were it not for the jurisdictional thicket that obscures Medicare cases, both precedent and equity would point toward immediate invalidation and vacation of the 1981 wage index due to defendants' clear violation of APA. Yet it is clear that to invalidate the 1981 wage index and enjoin defendants from retroactively applying any new schedule that excludes federal wage data might well permit plaintiffs to recover a larger amount of Medicare reimbursement than they would under the present 1981 schedule. Indeed, plaintiffs claim that they stand to lose about $500,000 "solely" due to the exclusion of federal wage data from the 1981 schedule. An injunction such as plaintiffs request would leave defendants no discretion; they would be bound to include federal wage data when determining plaintiffs' reimbursement amounts. Thus, unlike the situation in *NAHHA,* in this case "[g]ranting the requested relief *will* [or at least may well] . . . enable [plaintiffs] to receive larger reimbursements." 690 F.2d at 939 (emphasis supplied). This would be more nearly the "direct" result of the injunction than in previous cases, without resort to the remedies under § 1395oo.

The Court is therefore presented with the following puzzle: To render the full relief that plaintiffs request, i.e., invalidate the 1981 wage index and enjoin its application by defendants to plaintiffs' claims, would in this case directly determine that plaintiffs must receive Medicare monies from defendants that plaintiffs might not otherwise receive. Yet the Medicare statutes preclude jurisdiction over an unexhausted Medicare claim that would lead directly to an increased amount of reimbursement to a provider. On the other hand, the APA and interpretative cases indicate that, absent special factors not present here, plaintiffs

should be granted the relief they seek. An unlawfully promulgated regulation should be invalidated *ab initio*; otherwise, "the rulemaking provisions of the Administrative Procedure Act are completely trivialized." *N.L.R.B. v. Wyman-Gordon,* 394 U.S. 759, 781 (1969) (Harlan, J., dissenting) (quoted with approval in *Independant U.S. Tanker Owner Committee v. Lewis,* 690 F.2d 908, 921 (D.C. Cir. 1981)); *see also Independant U.S. Tanker Owners, supra,* 690 F.2d at 926 ("The only way to ensure that [APA violations] will not continue is to refuse to accept the decision resulting from [them]."). Thus, although the Court has jurisdiction under the APA to consider plaintiffs' procedural claim, its jurisdiction to render the full relief requested is in doubt.

After much consideration, it must be concluded that proper operation of the unique judicial review scheme created by Congress for Medicare claims would be most faithfully employed by denial of the injunction that plaintiffs request. Accordingly, the accompanying Order will declare that defendants' promulgation of the 1981 wage schedule without providing notice and comment on the decision to exclude federal government hospital wage data from the wage index violated the provisions of the APA, and that, consequently, the 1981 schedule was and is invalid insofar as it incorporated the unlawfully promulgated wage index. The effect of this declaration, however, upon determination of reimbursement levels for Medicare providers after June 30, 1981, must be determined in the first instance by the Secretary and her delegates administering the claims procedure; they are, of course, obligated to follow the law as it is finally interpreted by the Court. Plaintiffs can file any cost reimbursements claims they believe they have according to the administrative relief mechanism set up in § 1395oo. The Provider Reimbursement Review Board ("PRRB"), which also must follow the law, will then have the opportunity to consider

the effect of this Court's declaration on plaintiffs' claims; its decisions are in turn reviewable by the Secretary. Only after the Secretary makes her decision, or the PRRB determines that it has no authority to decide the effect of this Court's declaration on reimbursement claims, will jurisdiction lie in federal court again with respect to plaintiffs' claims for a particular level of reimbursement. *See* § 1395oo(f)(1).

The accompanying Order will not enjoin defendants from applying the 1981 schedule to plaintiffs' claims for reimbursement, although it will declare that the wage index used in that schedule was promulgated unlawfully and is consequently invalid. Plaintiffs may pursue their specific reimbursement claims administratively armed with that declaration, and may seek judicial review if they are dissatisfied with the PRRB's or the Secretary's ultimate determination. If the Secretary wishes to put in place a valid prospective wage index, she should begin proper notice and comment proceedings; any wage index currently in place that has been promulgated without notice and comment is invalid as was the 1981 schedule.[9]

/s/ LOUIS F. OBERDORFER
Date: April 29, 1983 United States District Judge

[9] Although defendants published an annual wage schedule from 1974 through 1981, the parties have not apprised the Court as to whether a new schedule was promulgated in 1982 or will be forthcoming in 1983. The 1981 Final Notice provided that the 1981 schedule would, with automatic adjustments, continue to apply in 1982 absent further action, *see* 46 Fed. Reg. at 33644, and defendants have referred in a footnote to the "1982 limits." Defendants' Points and Authorities, *supra,* at 7 n.6. If a schedule subsequent to the 1981 schedule was properly promulgated under the APA, then no new rulemaking is required. If notice and comment procedures have not been followed since 1980, however, as the parties' silence suggests, then the schedule has been invalid since its unlawful promulgation on June 30, 1981, and cannot be given lawful effect until proper rulemaking procedures are completed.

APPENDIX G

UNITED STATES DISTRICT COURT
FOR THE DISTRICT OF COLUMBIA

Civil Action No. 82-2520

DISTRICT OF COLUMBIA HOSPITAL ASSOCIATION, ET AL., PLAINTIFFS

v.

MARGARET HECKLER, ET AL., DEFENDANTS

[Filed Apr. 29, 1983]

ORDER

For the reasons stated in the accompanying Memorandum, it is this 29th day of April 1983, hereby

ORDERED: that defendants' Motion to Dismiss or in the Alternative for Summary Judgment is DENIED; and it is further

ORDERED: that plaintiffs' Motion for Summary Judgment is GRANTED; and it is further

ADJUDGED, DECEED and DECLARED: that defendants' decision to exclude data from federal government hospitals in developing the wage index used in the 1981 schedule for Medicare hospital cost limits, published at 46 Fed. Reg. 33638-33644 (June 30, 1981), *as amended* 46 Fed. Reg. 46406-07, without providing prior notice and comment proceedings, violated the rulemaking provisions of the Administrative Procedure Act, 5 U.S.C. § 553, and was unlawful; and it is further

ADJUDGED, DECREED and DECLARED: that, in consequence of defendants' unlawful failure to comply with the Administrative Procedure Act, the 1981 schedule

for Medicare hospital cost limits, insofar as it incorporates or was formulated by using a hospital wage index that excluded data from federal govenment hospitals, was and is invalid; and it is further

ORDERED: that defendants shall promptly place a notice in the *Federal Register* advising that the 1981 schedule for Medicare hospital cost limits has been declared invalid with regard to the wage index.

/s/ LOUIS F. OBERDORFER
United States District Judge

:: U.S. GOVERNMENT PRINTING OFFICE: 1987 – 202 037/60187

No. 87-1097

IN THE

Supreme Court of the United States

OCTOBER TERM, 1987

OTIS R. BOWEN, SECRETARY OF HEALTH AND HUMAN SERVICES,
Petitioner,

v.

GEORGETOWN UNIVERSITY HOSPITAL, *et al.*
Respondents.

On Petition for a Writ of Certiorari to the United States Court of Appeals for the District of Columbia Circuit

BRIEF IN OPPOSITION

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QUESTION PRESENTED

Whether the Secretary of Health and Human Services may validly apply a retroactive Medicare cost limit rule to recoup from respondents monies that he previously paid them as a result of a final court judgment.

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TABLE OF AUTHORITIES

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BRIEF IN OPPOSITION

STATUTES AND REGULATIONS INVOLVED

1. 5 U.S.C. § 551(4)—Appendix ("App.")[1] at 67a.
2. 5 U.S.C. § 553(b)-(d)—App. at 67a-68a.
3. 5 U.S.C. § 706—App. at 68a.
4. 42 U.S.C. § 1395x(v)(1)(A) (section 1861(v)(1)(A) of the Social Security Act)—App. at 69a-70a.
5. Pub. L. No. 92-603, § 223(b) (1972)—App. at 70a.
6. 42 C.F.R. § 413.9(b)(1)—App. at 70a-71a.
7. 42 C.F.R. § 413.30(a), (b)(3)—App. at 71a.
8. 42 C.F.R. § 413.64(a)(1), (b), (f)—App. at 71a-73a.

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[1] Pages 1a-66a of the Appendix will be found in the Secretary's petition. Later numbered pages are appended hereto.

STATEMENT OF THE CASE

The court of appeals' opinion accurately recounts the key facts of this case. App. at 2a-10a. Respondents furnish the following additional background regarding the statutory and regulatory framework.

The Medicare statute (title XVIII of the Social Security Act) was enacted in 1965. Pub. L. No. 89-97, § 102(a) (1965). It required that hospitals furnishing services to Medicare beneficiaries be reimbursed their "reasonable cost." 42 U.S.C. §§ 1395f(b), 1395x(v)(1)(A). It mandated that the Secretary's implementing regulations "take into account both direct and indirect costs" so that non-Medicare patients would not subsidize costs properly attributable to Medicare patients and Medicare would not subsidize costs properly attributable to non-Medicare patients. 42 U.S.C. § 1395x(v)(1)(A)(i); *Northwest Hospital, Inc. v. Hospital Service Corp.*, 687 F.2d 985, 991 (7th Cir. 1982). It also mandated that the Secretary's regulations "provide for the making of suitable retroactive corrective adjustments where, for a provider of services for any fiscal period, the aggregate reimbursement produced by the methods of determining costs proves to be either inadequate or excessive" (42 U.S.C. § 1395x(v)(1)(A)(ii))—referred to by the court of appeals as the "retroactive corrective adjustments provision" (App. at 6a n.5).

The Secretary published implementing regulations a year later. 31 Fed. Reg. 14,808 (1966). They provided that the "reasonable cost" reimbursement standard is "intended to meet . . . actual costs, however widely they may vary from one institution to another . . . subject to a limitation where a particular institution's costs are found to be substantially out of line with other institutions in the same area which are similar in size, scope of services, utilization, and other relevant factors." 20 C.F.R. § 405.451(c)(2) (1966). They construed the retroactive corrective adjustments provision as simply requiring a year-end settling of accounts reflecting the difference between what a provider is entitled to after a full audit of its cost report for a particular year and the amount of estimated payments

that it received during the year. *See* 20 C.F.R. § 405.454(f) (1966), redesignated 42 C.F.R. § 413.64(f) (App. at 72a-73a); 20 C.F.R. § 405.451(b)(1) (1966), redesignated 42 C.F.R. § 413.9(b)(1) (App. at 70a-71a); 20 C.F.R. § 405.454(a), (b) (1966), redesignated 42 C.F.R. § 413.64(a)(1), (b) (App. at 71a-72a).

Over time, Congress concluded that the original payment standard failed to provide proper incentives for efficiency and economy. H.R. Rep. No. 92-231, 92d Cong., 1st Sess. 82-85 (1971), Joint Appendix ("J.A.") [2] at 70-73; S. Rep. No. 92-1230, 92d Cong., 2d Sess. 187-190 (1972), J.A. at 74-77. It was also concerned that the Secretary's disallowance authority was too limited. *Id.* Accordingly, it amended the Medicare statute in 1972 to allow the Secretary to establish prospective cost limits. Pub. L. No. 92-603, § 223(b) (App. at 70a).

In 1974, the Secretary published a regulation to implement the authority to establish Medicare cost limits conferred on him by section 223(b) of the 1972 amendments. 39 Fed. Reg. 20,164 (1974). Consistent with the statutory language and the legislative history, the regulation specified that cost limits "will be imposed prospectively. . . ." 20 C.F.R. § 405.460(a) (1974), redesignated 42 C.F.R. § 413.30(a)(2) (App. at 71a).

Pursuant to that regulation, the Secretary published in 1974 his first schedule of limits applicable to "routine costs." [3] He thereafter published an annual schedule of routine cost limits for the next seven years. The last of these was the 1981 schedule, which applies only to hospital cost reporting years beginning in the period July 1, 1981 through September 30, 1982. 46 Fed. Reg. 33,637 (1981). In late 1984, the Secretary published the retroactive wage index rule at issue here as an after-the-fact component of the *1981* schedule of limits. 49 Fed. Reg. 46,495 (1984).

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[2] The Joint Appendix referred to in this brief was filed by the parties with the court of appeals.

[3] "Routine costs" include "regular room, dietary, and nursing services, and minor medical and surgical supplies." 42 C.F.R. § 413.53(b)(2).

SUMMARY OF ARGUMENT

The Secretary's petition should be denied for seven reasons.

First, this case involves unprecedented governmental overreaching. The Secretary promulgated and applied a retroactive rule to recoup from the respondents funds previously paid to them as a result of a final court judgment. He has openly acknowledged using retroactive rulemaking rather than the normal appeals process established by law to reverse the court decision. The district court and the court of appeals dealt with the Secretary's overreaching in an appropriate and, under the circumstances, very restrained manner.

Second, the Secretary's retroactive Medicare *cost limit* rule is invalid because the authorizing statutory provision (section 223(b) of the Social Security Amendments of 1972) and the accompanying congressional reports prohibit the Secretary from issuing retroactive *cost limit* rules. The prospectivity requirement is also plainly reflected in the Secretary's cost limit regulation, prior cost limit schedules, and administrative decisions.

Third, the broad construction of the retroactive corrective adjustments provision presented in the Secretary's petition is simply a *post hoc* rationalization of the Secretary's counsel that conflicts with the plain wording of the provision itself and the construction in the Secretary's own long-standing regulations. Moreover, even if the broad construction of the Secretary's counsel were generally correct, it would not assist the Secretary here. With respect to Medicare *cost limit* rules, the express prospectivity requirement established by section 223(b) would override the very general retroactive corrective adjustments provision.

Fourth, the court of appeals' Medicare holding does not conflict with the holding of any other circuit. No circuit has ever held that the Secretary may promulgate a retroactive *cost limit* rule. The recapture of accelerated depreciation cases cited by the Secretary, all decided in the 1970s, are not on point because they did not involve either a *cost limit* rule or a rule with significant (much less, as here, *total*) retroactive effect.

Fifth, the Medicare issue raised by the Secretary has virtually no current relevance or financial impact. There have been *no* Medicare cost limits applicable to *any* hospital in the country since October 1, 1983.

Sixth, the Administrative Procedure Act ("APA") question raised by the Secretary is not properly presented here. Because section 223(b) bars a retroactive cost limit rule, this Court need not consider whether the APA *also* bars the Secretary's retroactive rule. Moreover, the court of appeals' holding that, as a "general rule," the APA prohibits retroactive rulemaking is in accord with the APA's plain language, the accompanying legislative history, and prior decisions of this Court and other appellate courts. None of the cases cited by the Secretary involves circumstances even remotely similar to those here.

Seventh, affirmance of the judgment below does not require consideration of either of the questions presented by the Secretary. The district court's judgment is based on an entirely independent and discrete ground. The district court also implied agreement with four other discrete grounds advanced by the respondents.

ARGUMENT

The Court should deny the Secretary's petition for the seven reasons discussed below.

1.a. This case is unique. The Secretary's 1984 retroactive wage index rule apparently marks the first and only time that an administrative agency has applied a retroactive rule to recoup moneys previously paid by the agency as a result of a final court judgment. It also apparently marks the first and only time that an agency has by its own admission attempted to reverse a lower court judgment not through the appeals process but through retroactive rulemaking.

In *District of Columbia Hospital Association v. Heckler*, No. 82-2520 (D.D.C. Apr. 29, 1983) (App. at 49a-66a) (hereinafter, *DCHA*), the court invalidated the Secretary's 1981 wage index rule because the Secretary failed to promul-

gate the rule in accordance with the mandatory notice and comment procedures of the APA. The court expressly denied the Secretary's request to stay invalidation pending promulgation of a new rule utilizing notice and comment procedures.[4] App. at 60-61. It stated that an "unlawfully promulgated regulation should be invalidated *ab initio*" (App. at 63a), that "invalidation of the 1981 wage index and formula would leave in place the formula that was arrived at after proper notice and comment procedures and was used successfully to reimburse providers prior to July 1981" (App. at 61a), and that "[i]f the Secretary wishes to put in place a valid *prospective* wage index, she should begin proper notice and comment proceedings" (App. at 64a (emphasis added)). The Secretary did not appeal.

Following the *DCHA* decision, the Secretary paid the respondents for their *1981* years in accordance with the pre-existing 1979 wage index rule. However, more than a year and a half after *DCHA* became final, he applied his 1984 retroactive wage index rule to recoup from the respondents the monies he had previously paid them as a result of *DCHA*.[5] *The reopening notices issued by the Secretary's agents stated that the recoupment was "based on a reversal" of the DCHA decision effected through the Secretary's retroactive rulemaking. See, e.g.,* J.A. at 68, 69. The Secretary has also acknowledged in his filings with this Court that he used retroactive rulemaking as a substitute for appealing the adverse *DCHA* decision.[6] For sheer agency arrogance, this case is without precedent.

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[4] The court found that none of the conditions for granting such relief was present. App. at 60a-61a.

[5] *DCHA* became final on September 1, 1983. The Secretary's retroactive wage index rule was not published until November 26, 1984, and not applied to recoup funds previously paid to the respondents until April 1985.

[6] *See* Application for an Extension of Time Within Which to File a Petition for a Writ of Certiorari at 2 ("*Rather than appeal* [*DCHA*], the Secretary decided to resolve this matter through a new rulemaking proceeding that would make the new rule retroactive to the date of the original modification." (Emphasis added.)); Pet. at 11-12 ("When [the 1981 rule] was invalidated by the district court on procedural grounds in 1983, *the Secretary decided not to appeal that determination; instead*—after subjecting the regulation to prior notice and comment—*she reissued the regulation in 1984 and gave the revalidated regulation the same 1981 effective date as the original regulation.*" (Emphasis added.)).

b. The Secretary states that "[i]f an agency cannot retroactively correct even an insignificant procedural error, the government will be forced to seek review of many more adverse lower court decisions in order to protect the agency's regulatory authority." Pet. at 25. The Secretary's threat is based on the false premise that lower courts are likely to invalidate agency rules because of an "insignificant procedural error"; but under the APA "prejudicial error" rule (5 U.S.C. § 706 (final sentence)), they are not likely to do so. And if they do, the Secretary obviously should seek to reverse the decisions through the appeals process established by law rather than through vigilante retroactive rulemaking.

To the extent that the Secretary is suggesting that the failure to follow the notice and comment procedures mandated by the APA is an "insignificant procedural error," the Secretary is clearly mistaken. This Court has recognized the significance of these procedures and the duty of the courts to enforce compliance by federal agencies. *Chrysler Corp. v. Brown,* 441 U.S. 281, 303, 313, 316 (1979); *NLRB v. Wyman-Gordon Co.,* 394 U.S. 759, 765 (1979). The Secretary's retroactive rule has "trivialized" (App. at 37a) and made "a mockery of the provisions of the APA" (App. at 14a). As the court of appeals noted, "[o]bviously, agencies would be free to violate the rulemaking requirements of the APA with impunity if, upon invalidation of a rule, they were free to 'reissue' that rule on a retroactive basis." App. at 14a.

Moreover, if the Secretary can apply a "second-chance" retroactive rule against the respondents, what is to prevent him from imposing a "third-chance" retroactive rule if the "second-chance" retroactive rule fails or from imposing a "fourth-chance" retroactive rule if the "third-chance" retroactive rule fails? By repeatedly repromulgating retroactive wage index rules, the Secretary could engage respondents and the courts in endless litigation over respondents' *1981* Medicare reimbursement. Forcing respondents to continue to relitigate this matter for a cost reporting year long since past, as the Secretary creates new retroactive rules and new retroactive rulemaking records, is inconsistent with basic notions of justice and fair play and wasteful of judicial resources. *See Tallahassee Memorial*

Regional Medical Center v. Bowen, 815 F.2d 1435, 1454 n.38, 1455 & n.41, 1456 (11th Cir. 1987), *petition for cert. filed*, No. 87-380;[7] *Mason General Hospital v. Secretary of Department of Health and Human Services*, 809 F.2d 1220, 1225 (6th Cir. 1987); *Albany General Hospital v. Heckler*, 657 F. Supp. 87, 92 (D. Or. 1987), *appeal docketed*, No. 87-3688.

c. The Secretary appears to suggest that the 1984 retroactive wage index rule was not truly retroactive because the invalidated 1981 rule provided respondents with "ample notice" of the cost limits ultimately adopted in 1984. Pet. at 17. The Secretary ignores that the effect of *DCHA* was to invalidate the 1981 rule "*ab initio.*" *DCHA*, App. at 63a; *see also* App. at 37a. As the *DCHA* court pointed out (App. at 60a), that result is mandated by the APA, which provides that a "reviewing court *shall* . . . hold unlawful and *set aside* agency action . . . found to be . . . without observance of procedure required by law." 5 U.S.C. § 706 (emphasis added). Thus, there is no basis for the Secretary's facile assumption that the respondents should have relied on the *invalid* 1981 wage index rule, which they challenged in court (with eventual success), rather than the *valid* 1979 wage index rule.[8] Respondents could hardly have anticipated that the Secretary would attempt to deprive them of the fruits of their victory through a wholly unprecedented retroactive rulemaking and recoupment process.

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[7] The *Tallahassee* court aptly noted:

> In football, if a team gains ten yards on a play in which it commits a five yard penalty, the ball is typically taken back to the original line of scrimmage and the five yard penalty is counted off from there. Adopting the Secretary's approach would be like taking five yards off from the point where the play ended (and thus allowing the team a net five yards gain on a play in which it committed an infraction).

815 F.2d at 1455 n.41.

[8] This is particularly true because the 1981 wage index was patently invalid. The *DCHA* court found that the Secretary's invocation of the "good cause" exemption in publishing the 1981 wage index rule without prior notice and comment procedures "does not survive even deferential scrutiny," much less the strict scrutiny normally applied in this circumstance. App. at 58a. The Secretary essentially argued that "mere incantation" by the agency was sufficient to trigger the "good cause" exemption. *Id.*

Moreover, entirely aside from its invalidity, the original 1981 rule did not furnish the respondents with "ample notice." The rule was published without any advance notice on June 30, 1981, to become effective the next day, thereby violating not only the APA's notice and comment requirements, but also the APA's thirty day delayed effective date requirement (5 U.S.C. § 553(d)). Like other business entities, hospitals operate under established labor and supply contracts that generally cannot be terminated at will. Significantly, the Secretary had recognized in the past that "accommodation to a lower cost level may require adjustment of staff schedules and purchasing practices that is hard to accomplish quickly" and had allowed *one or two year* grace periods to allow hospitals sufficient time to effect such adjustments before applying significant new cost limit rules. 43 Fed. Reg. 25,873 (1978), J.A. at 84; *see also* 41 Fed. Reg. 36,992 (1976); 44 Fed. Reg. 46,949-46,950 (1979). The Secretary's assertion that the one day's prior notice furnished by the *invalid* 1981 schedule was "ample" is patently absurd.

2. Section 223(b) of the 1972 Social Security Amendments amended section 1861(v)(1)(A) of the Social Security Act, 42 U.S.C. § 1395x(v)(1)(A), to authorize the Secretary to establish limits on hospital costs "*to be recognized* as reasonable. . . ." App. at 70a (emphasis added). The emphasized language plainly requires the Secretary to establish the limits before the beginning of the period to which they apply. That is confirmed by the legislative history. In identical language, both the House and Senate reports specify that the cost limits set thereunder must be "exercised on a *prospective, rather than retrospective, basis* so that the provider would know *in advance* the limits to Government recognition of incurred costs and have the opportunity to act to avoid having costs that are not reimbursable." H.R. Rep. No. 92-231, 92d Cong., 1st Sess. 83 (1971), J.A. at 71 (emphasis added); S. Rep. No. 92-1230, 92d Cong., 2d Sess 188 (1972), J.A. at 75 (emphasis added). Both reports repeat that "the limits would be defined in advance. . . ." House Rep. at 84, J.A. at 72; Sen. Rep. at 188, J.A. at 75.

The Secretary has consistently recognized that section 223(b) authorizes only "prospective" limits. His original cost limit regulation expressly stated: "These limits will be imposed

prospectively. . . ." 20 C.F.R. § 405.460(a) (1974) (emphasis added), *published at* 39 Fed. Reg. 20,165 (1974).[9] Five years later, the Secretary added the following language:

> *Prior to the beginning of a cost period to which limits will be applied,* the Secretary will publish a notice in the *Federal Register,* establishing cost limits and explaining the basis on which they were calculated.

42 C.F.R. § 405.460(b)(3) (1979) (emphasis added), *published at* 44 Fed. Reg. 31,804 (1979). The present cost limit regulation retains both of these provisions requiring prospective application.[10] *See* 42 C.F.R. § 413.30(a)(2), (b)(3) (App. at 71a).

In addition, the preamble of each proposed and final schedule of routine cost limits ever published by the Secretary has specified that section 223(b) allows the imposition of "prospective limits" on the costs reimbursable under Medicare.[11] Ironically, even the 1984 proposed notice for the

[9] The subsection (a) prospectivity language was omitted when the regulation was revised in 1979, but was restored in 1982. The 1982 preamble explains:

> We are amending 42 CFR 405.460(a) . . . by adding a sentence . . . setting forth the general principle . . . that the limits . . . will be applied on a prospective basis. When we revised the regulations . . . [in 1979], reference to the prospectivity of the limits was inadvertently omitted. *We are now inserting language in the regulation to make it clear that the limits are to be applied prospectively.*

47 Fed. Reg. 43,286 (col. 1) (1982) (emphasis added).

[10] The Secretary purported to publish his 1984 retroactive wage index rule pursuant to the principles in his cost limit regulation (then codified as 42 C.F.R. § 405.460). *See* 49 Fed. Reg. 6,180 (col. 1) (1984) (proposed notice); 49 Fed. Reg. 46,501 (col. 2) (1984) (final notice). *Thus, the Secretary's retroactive cost limit rule was issued pursuant to a cost limit regulation that prohibits retroactive cost limit rules.*

[11] *See* 39 Fed. Reg. 10,313 (Mar. 19, 1974); 39 Fed. Reg. 20,168 (June 6, 1974); 40 Fed. Reg. 17,190 (Apr. 17, 1975); 40 Fed. Reg. 23,622 (May 30, 1975); 41 Fed. Reg. 18,465 (May 4, 1976); 41 Fed. Reg. 26,992 (June 30, 1976); 42 Fed. Reg. 40,948 (Aug. 12, 1977); 42 Fed. Reg. 53,675 (Oct. 3, 1977); 43 Fed. Reg. 25,869 (June 15, 1978); 43 Fed. Reg. 43,559 (Sept. 26, 1978); 44 Fed. Reg. 11,612 (Mar. 1, 1979); 44 Fed. Reg. 31,806 (June 1, 1979); 45 Fed. Reg. 21,582 (Apr. 1, 1980); 45 Fed. Reg. 41,868 (June 20, 1980); 46 Fed. Reg. 7,456 (Jan. 23, 1981); 46 Fed. Reg. 33,637 (June 30, 1981); 46 Fed. Reg. 48,010 (Sept. 30, 1981).

Secretary's retroactive wage index rule accurately stated that section 223(b) authorizes "*prospective* limits." 49 Fed. Reg. 6,176 (col. 1) (1984) (emphasis added).

The Secretary's consistent position is also reflected in his administrative decisionmaking. For example, in *Beth Israel Hospital v. Blue Cross Association*, CCH Medicare and Medicaid Guide ¶ 31,645 at 10,137 (Nov. 7, 1981) (J.A. at 78-83), the Secretary (through his delegate, the Deputy Administrator of the Health Care Financing Administration) held that "prospectivity requires" that "[t]he criteria for setting the limits and the limits themselves . . . be established for all categories prior to the cost reporting period."

Based on a review of the foregoing authorities, the court of appeals very appropriately noted that "we are astonished that the Secretary now purports to have the authority to promulgate [cost limit] rules on a retroactive basis." App. at 16a.

The Secretary's 1984 retroactive wage index rule significantly reduced respondents' Medicare cost limits for their *1981* years. A rule that reduces reimbursement for a period that began more than three years prior to its issuance cannot be considered "prospective." Accordingly, the Secretary's retroactive wage index rule plainly exceeds the Secretary's authority under section 223(b) and is therefore invalid.[12]

3. In his petition, the Secretary argues that the 1984 retroactive wage index rule was authorized by the retroactive corrective adjustments provision (42 U.S.C. § 1395x (v)(1)(A)(ii)). The Secretary never made any such contention during the rulemaking proceedings.[13] The contention is strictly a *post hoc* rationalization of the Secretary's counsel.[14]

[12] The preamble to the final retroactive wage index rule includes *no* response to the respondents' comment that § 223(b) precludes the Secretary from issuing a retroactive cost limit rule. *See* Rulemaking Record ("Rec.") at 143-144. This is one of several reasons why the Secretary's "basis and purpose" statement was inadequate. *See* § 7 below.

[13] The Secretary stated that he was acting pursuant to § 223(b) (49 Fed. Reg. 6,176 (col. 1) (1984)) and purported to justify issuance of the retroactive wage index rule on "substantial legal authority" applicable to all agencies (49 Fed. Reg. 46,497 (col. 2) (1984)).

[14] The court of appeals held that the Secretary's reliance on the retroactive corrective adjustments provision must fail because he raised that

(footnote continues)

With respect to *cost limit* rules, the very general retroactive corrective adjustments provision must be construed in light of the more specific language added by section 223(b). Prior to 1972, the Secretary had no authority to issue *any* Medicare *cost limit* rules, prospective or retrospective. The only provision that grants him the authority to issue such rules is section 223(b). Yet, as discussed above, section 223(b) clearly prohibits the issuance of retroactive cost limit rules. Obviously, the retroactive corrective adjustments provision could not authorize the Secretary to issue retroactive cost limit rules when the only statutory authority for the issuance of cost limit rules prohibits the Secretary from issuing them retroactively. As the Secretary concedes, the retroactive corrective adjustments provision "does not override other provisions of the Medicare Act." Pet. at 17 n.10. Thus, even if the Secretary's broad *post hoc* construction of the retroactive corrective adjustments provision were correct, it would not change the result here because of the special considerations applicable to section 223(b) rules.

But it is clear that the *post hoc* construction of the Secretary's counsel is not correct. The provision does not authorize the Secretary to issue retroactive rules. Instead, it *requires* the Secretary to establish regulations that "provide *for the making of* retroactive corrective adjustments. . . ." App. at

(footnote continued)

issue for the first time in litigation. App. at 16a. (The court also, however, addressed and rejected the Secretary's contention on the merits. *See* App. at 16a-19a.) In reaching this conclusion, the court of appeals relied on the explicit APA requirements that (1) notice of proposed rules contain "reference to the legal authority under which the rule is proposed" (5 U.S.C. § 553(b)(2)) and (2) final rules include "a concise general statement of their basis and purpose" (5 U.S.C. § 553(c)). In his petition, the Secretary cites four cases which, he claims, support the proposition that an agency may rely in court on a legal basis not asserted by the agency at the time of the challenged action. Pet. at 16 n.9. However, none of these cases involved an agency's belated attempt to justify a rule published under APA notice and comment rulemaking procedures. Significantly, in *Baylor University Medical Center v. Heckler*, 758 F.2d 1052, 1060 (5th Cir. 1985), a case relied upon by the Secretary, the Fifth Circuit stated that, where APA notice and comment procedures are required, the "goals" of the APA would be "frustrated" if courts "allowed an administrative agency to rely on reasons for past action that it was unable or unwilling to articulate at the time the action was taken."

69a-70a (emphasis added). In other words, Congress ordered the Secretary to issue a regulation that establishes *a process* for making certain "adjustments." "Adjustments," of course, are normally made to "reimbursement" or payments, not regulations. Moreover, these particular "adjustments" are to be made "where, *for a provider of services for any fiscal period, the aggregate reimbursement* produced by the methods of determining costs *proves to be* either *inadequate or excessive.*" *Id.* at 70a (emphasis added). Thus, to properly make the adjustments, the Secretary must determine a *particular provider's* "aggregate reimbursement" for a *particular period* and then determine whether that "aggregate reimbursement" was "inadequate or excessive." *Id.* The Secretary can obviously do that only on a case-by-case basis. Thus, the Secretary's *post hoc* suggestion that this provision authorizes the promulgation of retroactive rules of general applicability conflicts with the plain wording of the provision.

The Secretary has, in fact, *never* published any regulation that has set up a process for issuing retroactive rules.[15] He has, however, published regulations that have set up a process for making retroactive adjustments on a case-by-case basis. These regulations, which date from 1966, require the Secretary's agents to make retroactive adjustments for each provider to reconcile the amount to which the provider is entitled after a full audit with the amount of estimated payments received by the provider during the year. *See* 42 C.F.R. § 413.64(a)(1), (b), (f) (App. at 71a-73a); 42 C.F.R. § 413.9 (App. at 70a-71a). Thus, the Secretary's broad *post hoc* construction of the retroactive corrective adjustments provision is contradicted by his own regulations.

It also conflicts with the construction adopted by the agency near the time of the provision's enactment. In congressional hearings held in 1966, Robert M. Ball, then Commissioner of the Social Security Administration (the agency originally responsible for administering the Medicare program),

[15] The retroactive corrective adjustments provision is phrased in mandatory language. Thus, if the Secretary's broad *post hoc* construction of the provision is correct, the Secretary has been in violation of the law for the past twenty-two years.

stated that the provision does not authorize the agency to change reimbursement rules retroactively and construed the provision, consistent with the regulations issued shortly thereafter, as simply requiring a year-end reconciliation based on the results of a final audit.[16] *See Mason General Hospital,* 809 F.2d at 1225-1226; *Daughters of Miriam Center for the Aged v. Mathews,* 590 F.2d 1250, 1258-1259 n.23 (3d Cir. 1978). An agency's contemporaneous construction is, of course, entitled to considerable deference. *General Electric Co. v. Gilbert,* 429 U.S. 125, 142 (1976). Thus, even outside the section 223(b) context involved here, there is no merit to the broad *post hoc* construction of the retroactive corrective adjustments provision presented in the Secretary's petition.[17]

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[16] Commissioner Ball testified:

> Payments [to Medicare providers] will be made for services throughout the year and final settlement on a retroactive basis will be made at the end of the accounting period. Continuing payments will be made as often as possible and in no event less frequently than once a month. The retroactive payments will take fully into account costs as they were actually incurred, *determined according to the agreed upon principles of reimbursement—we don't retroactively change the principles*—and settlement will be on an incurred rather than on an estimated basis.

Reimbursement Guidelines for Medicare, Hearings Before the Senate Committee on Finance, 89th Cong., 2d Sess. 56 (1966) (emphasis added).

> *I don't think that the retroactive provision contemplates going back over the year and changing the principles.*
>
> • • • •
>
> It would hardly seem reasonable at the end of the year, after hospitals had entered into an agreement with you on the basis of certain principles, to shift all the principles for retroactive settlement in terms of how you compute a cost. *I don't think that was contemplated at all.*

Id. at 119 (emphasis added).

[17] In *Heckler v. Community Health Services of Crawford County, Inc.,* 467 U.S. 51, 53-54 (1984), this Court adopted the same construction of the retroactive corrective adjustments provision contained in the Secretary's regulations and reflected in Commissioner Ball's congressional testimony:

> Providers receive interim payments at least monthly covering the cost of services they have rendered. [42 U.S.C.] § 1395g(a). Congress recognized, however, that these interim payments would not always correctly reflect the amount of reimbursable costs, and accordingly instructed the Secretary to develop mechanisms for making appropriate retroactive adjustments when reimbursement is found to be inadequate or excessive. § 1395x(v)(1)(A)(ii).

4. The D.C. Circuit's decision is not in conflict with the decision of any other appellate court. No other appellate court has considered the validity of the Secretary's 1984 retroactive wage index rule.[18] Nor does the D.C. Circuit's decision conflict in principle with the decision of any other appellate court. No appellate court has *ever* held that the Secretary may promulgate a retroactive *cost limit* rule.[19]

The closest analogy to the Secretary's 1984 retroactive wage index rule is the Secretary's 1986 rule governing the apportionment of malpractice costs. The Secretary published the 1986 malpractice rule after literally scores of courts invalidated his 1979 malpractice rule and ordered payment under the preexisting rule.[20] To date, all nine courts that have considered the issue have refused to allow the Secretary to apply the 1986 malpractice rule retroactively. *See Mason General Hospital; Tallahassee Memorial Regional Medical Center; St. Peter's Medical Center v. Heckler,* 813 F.2d 398 (3d Cir. 1987); *Albany General Hospital; Miami General Hospital v. Bowen,* 652 F. Supp. 812 (S.D. Fla. 1986); *West Anaheim Community Hospital v. Bowen,* CCH Medicare and Medicaid

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[18] In *Leila Hospital and Health Center v. Bowen,* 661 F. Supp. 394 (W.D. Mich. 1987) and 661 F. Supp. 397 (W.D. Mich. 1987), *appeal docketed,* No. 87-1202, the court upheld the validity of the 1984 retroactive wage index rule under the facts of that case. However, unlike the respondents, the *Leila* plaintiff did not obtain a court judgment invalidating the 1981 rule, receive payment under the preexisting 1979 rule, suffer recoupment under the 1984 rule, or attack the substantive validity of the 1984 rule. The *Leila* court noted that it agreed with the district court's judgment in the instant case, but concluded that it was faced with "a different case, with different facts that require a different result." 661 F. Supp. at 406.

[19] The only cases cited by the Secretary that even arose in the context of the Secretary's cost limits are *Regents of the University of California v. Heckler,* 771 F.2d 1182 (9th Cir. 1985), and *St. Paul-Ramsey Medical Center v. Bowen,* 816 F.2d 417 (8th Cir. 1987). Neither case involved an attempt by the Secretary to apply a cost limit rule retroactively. Both courts construed the retroactive corrective adjustments provision as requiring the Secretary to make an adjustment where, *in a particular case,* an individual provider *proves* that the Secretary's reimbursement methods result in inadequate payment. That construction is entirely consistent with the construction of the D.C. Circuit in this case. *See* App. at 16a-19a.

[20] The appellate court decisions reaching this result are listed in *Mason General Hospital,* 809 F.2d at 1223 n.2. As noted there, this Court denied the Secretary's petitions for *certiorari* in all three cases in which they were filed.

Guide ¶ 36,609 (C.D. Cal. July 13, 1987), *appeal docketed,* No. 87-6391; *St. Joseph's Hospital v. Bowen,* CCH Medicare and Medicaid Guide ¶ 36,437 (D. Ariz. April 15, 1987), *appeal docketed,* No. 87-2338; *Bethesda Community Hospital v. Heckler,* CCH Medicare and Medicaid Guide ¶ 36,654 (S.D.N.Y. Aug. 5, 1987); *Childrens Hospital of San Francisco v. Bowen,* CCH Medicare and Medicaid Guide ¶ 36,679 (E.D. Cal. Sep. 3, 1987), *appeal docketed,* No. 87-2957.

The case against the Secretary is much stronger here. Unlike the 1984 retroactive wage index rule, the 1986 malpractice rule is *not* a cost limit rule and thus is not subject to the express prospectivity requirement established by section 223(b). Moreover, the Secretary has not attempted to apply the 1986 malpractice rule to recoup any monies paid as a result of prior court judgments (as he has done here) and has even strongly implied that it would be unlawful for him to do so. *See* 51 Fed. Reg. 11,149 (col. 3), 11,186 (cols. 2 and 3), and 11,187 (col. 2) (1986) ("Adoption of this final rule is not unlawful since all final, non-appealable judgments mandating . . . reimbursement [under the rule in effect before 1979] will be complied with.").

Most of the other Medicare cases cited by the Secretary's petition involve the Secretary's recapture of accelerated depreciation regulation, *which also was not a cost limit regulation.* The recapture regulation was primarily prospective and had only incidental retroactive effect. The Secretary validly announced the rule six months before it became effective. A provider could have avoided recapture by withdrawing from the program during that period. After the rule became effective, a provider could have avoided application of the rule by simply remaining in the program until all assets subject to accelerated depreciation were fully depreciated. The rule affected only those providers that chose to withdraw from the Medicare program *after* the effective date of the new rule but *before* the assets subject to accelerated depreciation were fully depreciated. The courts upholding the Secretary's regulation focused closely on its very limited retroactivity. *Springdale Convalescent Center v. Mathews,* 545 F.2d 943, 956 (5th Cir. 1977) ("The retroactive portion of the Secretary's regulation is narrowly drawn."); *Hazelwood Chronic and Convalescent Hospital, Inc. v. Weinberger,* 543 F.2d 703, 708 (9th Cir. 1976),

vacated and remanded on other grounds, 430 U.S. 952 (1977) ("The retroactive effects of the instant regulation were limited and reasonable."); *Adams Nursing Home of Williamstown, Inc. v. Mathews,* 548 F.2d 1077, 1080 n.8 (1st Cir. 1977); *Fairfax Nursing Center, Inc. v. Califano,* 590 F.2d 1297, 1302 (4th Cir. 1979).

The Secretary relies primarily on the *Springdale* case for a broad construction of the retroactive corrective adjustments provision. Pet. at 13. However, the Eleventh Circuit, which is bound by 1977 Fifth Circuit precedent,[21] recently construed *Springdale* much more narrowly than the Secretary, emphasizing that the *Springdale* court was addressing a regulation that was "predominantly prospective in nature." *Tallahassee,* 815 F.2d at 1454 n.37; *see also Mason General,* 809 F.2d at 1225-1227. In contrast, the instant case involves a rule that is entirely retroactive. The 1984 retroactive wage index rule was issued in November 1984 to be applicable solely to cost reporting years beginning in the period July 1, 1981—September 30, 1982. The Secretary has cited no Medicare court case (or any other court case, for that matter) that has tolerated retroactivity of this nature.

5.a. This case has virtually no practical significance. The rule at issue was entirely retroactive even when published in 1984 and thus obviously has no current applicability in 1988. Moreover, it appears that only one other hospital in the country is challenging the Secretary's retroactive wage index rule—and it is doing so under significantly different circumstances. *See Leila Hospital and Health Center v. Bowen.*

The question whether section 223(b) bars the promulgation and application of a retroactive cost limit rule also has virtually no current relevance. With the exception of the 1984 retroactive rule involved here, the last time that the Secretary established section 223(b) limits *applicable to hospitals* was in 1982, and those limits applied only to cost reporting years beginning in the period October 1, 1982-September 30, 1983.

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[21] *See Bonner v. City of Pritchard, Alabama,* 661 F.2d 1206, 1207 (11th Cir. 1981) (holding that the Eleventh Circuit is bound by Fifth Circuit decisions issued before the Eleventh Circuit came into existence).

See 47 Fed. Reg. 43,282 (1982). *No* hospital in the country has been subject to *any* section 223(b) limits for *any* costs for *any* cost reporting year beginning after September 30, 1983.[22]

It is true that the Secretary has continued to promulgate and apply section 223(b) cost limits to home health agencies and skilled nursing facilities. However, home health agencies and skilled nursing facilities account for only slightly more than four percent of total Medicare expenditures.[23] *No* section 223(b) cost limits are applicable to the remaining ninety-six percent.

b. Despite considerable effort, respondents have found no evidence to support the Secretary's bald assertion that "many" pending cases "involve challenges to the Secretary's authority to promulgate retroactive cost limit regulations." Pet. at 24 n.15. Respondents have found only one other pending court case involving this issue—*Leila Hospital,* discussed above.[24] Given that the Secretary has generally faithfully adhered to the prospectivity requirement of section 223(b) and that no section 223(b) cost limits have been applicable to hospitals for nearly five years, respondents can discern no reason why there should

[22] The Secretary correctly notes that some hospitals are exempt from the new prospective payment system ("PPS") and that even hospitals subject to PPS continue to be paid on a modified cost basis for certain costs. Pet. at 23-24. However, the Secretary fails to point out that there are *no* section 223(b) limits applicable to any exempt hospitals or exempt hospital costs, nor have there been any since October 1, 1983.

[23] According to the most recent *published* figures which respondents were able to find, home health agencies and skilled nursing facilities accounted for 3.4% of total Medicare expenditures in 1983. *See* Gornick, Greenberg, Eggers & Dobson, *Twenty Years of Medicare and Medicaid: Covered Populations, Use of Benefits, and Program Expenditures,* Health Care Financing Rev. 13, 43 (Supp. 1985). However, respondents have been advised that home health agencies and skilled nursing facilities accounted for approximately 4.3% of total Medicare expenditures in 1986. Telephone interview with Dick Lyman, Branch Chief, HCFA Statistical Services (Jan. 25, 1988) (citing Office of the Actuary, Division of Medicare, Estimated Hospital Insurance Disbursements (1987) and Medical Insurance Disbursements (1987) (cost estimates for calendar year 1986)).

[24] Hundreds of hospitals are challenging the validity of the Secretary's 1986 retroactive malpractice rule, discussed above. However, it is a cost apportionment, not a cost limit, rule. It was not published under the authority of § 223(b) and does not implicate § 223(b) in any way.

be any—much less many—other court cases involving this question. Absent supporting documentation, the Secretary's assertion should be disregarded.

6.a. This is not an appropriate case for resolving the APA question raised by the Secretary. Because section 223(b) clearly barred promulgation of the 1984 retroactive wage index rule, the Court need not reach the issue whether the APA *also* barred promulgation of the rule.[25] However, assuming that this question is considered, the APA also requires invalidation of the Secretary's rule.

The APA clearly establishes a general rule against the promulgation of retroactive rules. It defines a rule as "an agency statement of . . . *future effect*" which "includes the approval or prescription *for the future*" of certain matters. 5 U.S.C. § 551(4) (emphasis added), App. at 67a.[26] Statements of the legislation's sponsors[27] and passages from the

[25] The Secretary acknowledges that the "threshold inquiry is whether the substantive statute granting rulemaking authority imposes any restriction upon the agency's authority to apply rules retroactively." Pet. at 21. The answer to that inquiry here is an unequivocal yes: § 223(b) plainly prohibits the Secretary from promulgating a retroactive cost limit rule. Thus, § 223(b) is dispositive of this case, and there is no need to reach the APA issue.

[26] The Secretary argues that the APA definition simply means that "any application or enforcement will occur *only in the future, i.e.,* in an adjudication." Pet. at 19 (original emphasis). Aside from conflicting with the plain wording of the statutory provision, the Secretary's construction is contradicted by what happened here. The Secretary enforced his 1984 retroactive wage index rule without the benefit of "an adjudication"; he simply recouped from the respondents' Medicare payments the amounts previously paid under *DCHA.*

[27] *See* Proceedings from the Congressional Record, *Legislative History of the Administrative Procedure Act, 1944-1946,* at 355 ("In rule making an agency is not telling someone what his rights or liabilities are for past conduct or present status under existing law. Instead, in rule making the agency is prescribing what the future law shall be so far as it is authorized so to act.") (remarks of Congressman Francis E. Walter); *id.* at 374 ("[The bill] requires that . . . rules or regulations which have the effect of law must . . . go into effect at some future date.") (remarks of Congressman John W. Gwynne).

Attorney General's Manual on the APA [28] confirm that Congress meant exactly what it said. So does a decision of this Court issued one year after the APA was enacted. *See SEC v. Chenery Corp.*, 332 U.S. 194, 202 (1947) ("Since the Commission, unlike a court, does have *the ability to make new law prospectively through the exercise of its rule-making powers,* it has less reason to rely upon ad hoc adjudication to formulate new standards of conduct.... The function of filling in the interstices of the Act should be performed, as much as possible, through this *quasi-legislative promulgation of rules to be applied in the future.*" (Emphasis added.)).

The Secretary cites a passage from the report of the House Judiciary Committee which states that "[t]he phrase 'future effect' does not preclude agencies from considering and, so far as legally authorized, dealing with past transactions in prescribing rules for the future." Pet. at 20. However, that passage supports respondents, not the Secretary. "[D]ealing with past transactions in prescribing rules for the future" is different from prescribing rules for the past. It is the latter type of rule that is involved in this case and which is generally prohibited by the APA.

The Secretary also relies on the following passage in the *Attorney General's Manual on the APA:* "Nothing in the Act precludes the issuance of retroactive rules when otherwise legal and accompanied by the finding [of good cause] required by [5 U.S.C. § 553(d)]. H.R. REP. p. 49, fn.1 (Sen. Doc. p. 283)." *Manual* at 37. However, that passage expressly cites as authority the passage from the House Report examined in the preceding paragraph of this brief. Thus, the Attorney General was simply using the term "retroactive rules" loosely to describe rules that deal with past transactions in prescribing standards for the future. This is confirmed by other passages in the *Manual* that clearly reflect that the Attorney General did not believe that the APA allows an agency to prescribe rules for the past. *See* note 28 above. The passage cited by the Secretary does not, in any event, help the Secretary here because the Secretary's 1984 retroactive wage index rule was not accompanied by a "good cause" finding (*see* 49 Fed. Reg. 46,495 (1984)) and, as the court of appeals expressly found, does not come "within any conceivable 'good cause' exception" (App. at 12a n.11).

[28] *See* Justice Department, *Attorney General's Manual on the Administrative Procedure Act* 13 (1947) ("Of particular importance is the fact that 'rule' includes agency statements not only of general applicability but also those of particular applicability applied either to a class or to a single person. In either case, they must be of *future effect,* implementing or prescribing future law." (original emphasis)); *id.* at 14 ("Rule making is agency action which regulates the future conduct of either groups of persons or a single person; it is essentially legislative in nature, not only because it operates in the future but also because it is primarily concerned with policy considerations. The object of the rule making proceeding is the implementation or prescription of law or policy for the future, rather than the evaluation of a respondent's past conduct."); *id.* at 28 ("[5 U.S.C. § 553(d)] is not intended to hamper the agencies in cases in which there is good cause for putting a rule into effect immediately, or at some time earlier than thirty days.").

b. The APA does not expressly provide any exceptions to the "general rule" requiring that agency rules be of "future effect." [29] However, even if exceptions are appropriate in certain cases, this is not one of them for several reasons:

(1) The 1984 wage index rule retroactively rescinded the 1979 wage index rule, which had been duly promulgated in accordance with APA notice and comment procedures. The 1984 rule was thus not promulgated to fill a void.

(2) The Secretary promulgated the 1984 retroactive wage index rule to reverse *DCHA*.

(3) The Secretary applied the 1984 retroactive wage index rule to recoup from the respondents over $2.5 million that they had received as a result of *DCHA*.

(4) The 1984 retroactive wage index rule is totally devoid of "future effect." It applies solely to cost reporting years beginning in a fifteen month period that closed more than two years before the 1984 rule was even promulgated.

[29] 5 U.S.C. § 553(d)(3) allows an exception to the normal thirty day delayed effective date requirement "for good cause found and published with the rule." However, construed literally, the exception only allows an agency to make a rule effective immediately or in less than thirty days, not retroactively.

(5) The Secretary did not even attempt to invoke a "good cause" exception when he published the retroactive wage index rule. *See* 49 Fed. Reg. 46,495 (1984). Moreover, the court of appeals expressly found that "the reasons advanced by the Secretary in his notice for promulgating" the rule "plainly do not bring [it] within any conceivable 'good cause' exception." App. at 12a n.11.

The court of appeals' APA holding does not conflict in principle with the holding of any other appellate court.[30] None of the cases cited by the Secretary (Pet. at 18-19) involves any of the five circumstances discussed in the preceding paragraph. Indeed, none of the rules in the cases cited by the Secretary was even primarily retroactive. To the extent that the cases involved retroactivity at all, it was retroactivity incidental to a predominantly prospective rule.[31]

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[30] The Secretary has mischaracterized the court of appeals' APA holding throughout his petition. *See, e.g.*, Pet. at 18 (stating that the court's determination "rests on the novel conclusion that the APA prohibits virtually all retroactive rulemaking. . . ."). The court's exact words were:

> Appellant characterizes our opinion as holding that the Administrative Procedure Act imposes a "per se" ban on retroactive rulemaking. As a general rule, the APA requires that legislative rules be given future effect only. Whatever exceptions might exist to this general rule were not implicated in the case before us. Our opinion therefore does not purport to address circumstances in which there may be an exception to the rule against retroactive rulemaking.

App. at 45a.

[31] Courts have sometimes loosely characterized as "retroactive" rules that have an impact upon preexisting interests. For example, in *General Tel. Co. v. United States*, 449 F.2d 846 (5th Cir. 1971), one of the cases relied on by the Secretary (Pet. at 19), the Federal Communications Commission adopted a rule prohibiting telephone companies from furnishing cable television services. The rule was applied prospectively; however, its effect was to require some companies to divest their cable television services. Thus, the rule had an incidental "retroactive" effect in that it modified preexisting interests. This type of "retroactive" rule, however, is hardly analogous to the Secretary's retroactive wage index rule, which has no prospective application, but operates wholly retroactively.

c. The court of appeals' conclusion that the invalidation of an agency rule generally has the effect of leaving in place the preexisting rule (App. at 13a) is in accord with the conclusions of other circuits. *See, e.g., Mason General Hospital*, 809 F.2d at 1223, 1229; *Tallahassee Memorial Regional Medical Center*, 815 F.2d at 1453 n.35, 1455-1456; *Abington Memorial Hospital v. Heckler*, 750 F.2d 242, 244 (3d Cir. 1984), *cert. denied*, 106 S. Ct. 180 (1985); *Lloyd Noland Hospital and Clinic v. Heckler*, 762 F.2d 1561, 1569 (11th Cir. 1985); *Menorah Medical Center v. Heckler*, 768 F.2d 292, 297 (8th Cir. 1985); *Cumberland Medical Center v. Secretary of Health and Human Services*, 781 F.2d 536, 538-539 (6th Cir. 1986); *DeSoto General Hospital v. Heckler*, 766 F.2d 182, 186, *modified on rehearing*, 766 F.2d 186, *original opinion reinstated on rehearing of rehearing*, 776 F.2d 115, 116 (5th Cir. 1985); *Action on Smoking and Health v. CAB*, 713 F.2d 795, 797 (D.C. Cir. 1983). The three decisions of this Court on which the Secretary relies (Pet. at 20) all involved, as the Sixth Circuit has noted, special circumstances justifying a departure from the general rule, which circumstances are not present in the instant case. *See Cumberland*, 781 F.2d at 538.

The court of appeals' conclusion regarding the effect of invalidation simply reaffirmed what the *DCHA* court had held more than four years earlier. If the Secretary was not prepared to accept that holding, he should have appealed *DCHA*. The principle of *res judicata* now precludes him from attempting to relitigate this issue against the respondents.

7. It is not necessary for the Court to address either of the two questions raised by the Secretary. The district court did not rule on these questions. Instead, it ruled in respondents' favor based on the balancing test generally applied to retroactive agency rules adopted in adjudication, *i.e.*, it found that the inequity of applying the Secretary's retroactive rule to the respondents far exceeded any statutory interest underlying the rule.

In its analysis, the district court also strongly implied agreement with (1) respondents' contention that the Secretary's rule violates the Medicare statute's "reasonable cost" reimbursement mandate ("application of the reissued wage

index rule to these plaintiffs would have resulted in under-reimbursement of legitimate costs—which would contravene the purposes of the Medicare statutes." App. at 36a); (2) respondents' contention that the rule is arbitrary and capricious because the Secretary failed to take into account relevant factors ("the Secretary has in this case failed to confront with sufficient particularity . . . the effect of area differentials and *relevant* labor markets on average hospital wage levels." App. at 37a (original emphasis)); (3) respondents' contention that the Secretary failed to publish an adequate "basis and purpose" statement ("the notice and comment 'procedural correction' was in critical respects simply *pro forma.*" App. at 38a); and (4) respondents' contention that the rule violated the APA's thirty day delayed effective date requirement ("the Secretary's action does appear to violate 5 U.S.C. § 553(d)'s requirement that rules must have a thirty day delayed effective date." App. at 33a).

The nature of an opposition brief precludes an extended discussion of the substantive defects in the Secretary's rule, but one point in particular should be noted. The Secretary's retroactive wage index rule is based on the assumption that a metropolitan statistical area ("MSA") constitutes a homogeneous economic unit. However, as respondents pointed out in their public comments (*see* Rec. at 96-141, 152-153), that assumption is mistaken. For instance, the District of Columbia MSA includes Calvert, Charles, Frederick, and Montgomery Counties, Maryland, and Fairfax County, Fairfax City, Loudoun County, Manassas City, Manassas Park City, Prince William and Stafford Counties, Virginia—an area extending all the way to West Virginia to the West, Pennsylvania to the North, the Chesapeake Bay to the East, and more than halfway to Richmond to the South. Rec. at 152. Labor costs are much lower in Loudoun, Prince William, and Stafford Counties (all of which are largely rural) than in the District of Columbia. *Id.* at 124. The Secretary's retroactive wage index rule has removed from the applicable wage pool the high wages of the federal government hospitals with which District of Columbia hospitals must compete for employees, but has retained in the

wage pool the relatively low wages of distant suburban and rural hospitals with which the District of Columbia hospitals do not compete, thereby significantly lowering the wage index properly applicable to District of Columbia hospitals. That makes absolutely no sense and, as the district court found, results in the "under-reimbursement of legitimate costs—which . . . contravene[s] the purposes of the Medicare statutes." [32] *See* App. at 36a.

The two questions presented by the Secretary only scratch the surface of the questions raised by respondents below. The Secretary's rule is invalid on seven discrete grounds, any of which alone is sufficient to affirm the lower court judgment. Thus, if the Court were to hear this case, it might well never reach, as the district court did not reach, the two questions presented by the Secretary.

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[32] There is no basis whatsoever for the Secretary's assertion that application of the retroactive wage index rule was required to prevent the respondents from retaining a "windfall" or "excess reimbursement." Pet. at 22. Significantly, both courts below strongly disagreed with the Secretary's unsupported assertion. App. at 12a n.11, 18a-19a & n.16; *id.* at 36a-37a.

CONCLUSION

For the foregoing reasons, the Court should deny the Secretary's petition for a writ of *certiorari.*

Respectfully submitted,

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APPENDIX H

STATUTES AND REGULATIONS INVOLVED

1. 5 U.S.C. § 551(4)—

For the purpose of this subchapter—

• • • • •

(4) "rule" means the whole or a part of an agency statement of general or particular applicability and future effect designed to implement, interpret, or prescribe law or policy or describing the organization, procedure, or practice requirements of an agency and includes the approval or prescription for the future of rates, wages, corporate or financial structures or reorganizations thereof, prices, facilities, appliances, services or allowances therefor or of valuations, costs, or accounting, or practices bearing on any of the foregoing.

2. 5 U.S.C. § 553(b)-(d)—

(b) General notice of proposed rule making shall be published in the Federal Register, unless persons subject thereto are named and either personally served or otherwise have actual notice thereof in accordance with law. The notice shall include—

(1) a statement of the time, place, and nature of public rule making proceedings;

(2) reference to the legal authority under which the rule is proposed; and

(3) either the terms or substance of the proposed rule or a description of the subjects and issues involved.

• • • • •

(c) After notice required by this section, the agency shall give interested persons an opportunity to participate in the rule making through submission of written data, views, or arguments with or without opportunity for oral presentation. After consideration of the relevant matter

presented, the agency shall incorporate in the rules adopted a concise general statement of their basis and purpose. . . .

(d) the required publication or service of a substantive rule shall be made not less than 30 days before its effective date, except—

(1) a substantive rule which grants or recognizes an exemption or relieves a restriction;

(2) interpretative rules and statements of policy; or

(3) as otherwise provided by the agency for good cause found and published with the rule.

3. 5 U.S.C. § 706—

To the extent necessary to decision and when presented, the reviewing court shall decide all relevant questions of law, interpret constitutional and statutory provisions, and determine the meaning or applicability of the terms of an agency action. The reviewing court shall—

(1) compel agency action unlawfully withheld or unreasonably delayed; and

(2) hold unlawful and set aside agency action, findings, and conclusions found to be—

(A) arbitrary, capricious, an abuse of discretion, or otherwise not in accordance with law;

(B) contrary to constitutional right, power, privilege, or immunity;

(C) in excess of statutory jurisdiction, authority, or limitations, or short of statutory right; [or]

(D) without observance of procedure required by law;

* * * * *

In making the foregoing determinations, the court shall review the whole record or those parts of it cited by a party, and due account shall be taken of the rule of prejudicial error.

4. 42 U.S.C. § 1395x(v)(1)(A) (Section 1861(v)(1)(A) of the Social Security Act)—

The reasonable cost of any services shall be the cost actually incurred, excluding therefrom any part of incurred cost found to be unnecessary in the efficient delivery of needed health services, and shall be determined in accordance with regulations establishing the method or methods to be used, and the items to be included, in determining such costs for various types or classes of institutions, agencies, and services. . . . In prescribing the regulations referred to in the preceding sentence, the Secretary shall consider, among other things, the principles generally applied by national organizations or established prepayment organizations (which have developed such principles) in computing the amount of payment, to be made by persons other than the recipients of services, to providers of services on account of services furnished to such recipients by such providers. Such regulations may provide for determination of the costs of services on a per diem, per unit, per capita, or other basis, may provide for using different methods in different circumstances, may provide for the use of estimates of costs of particular items or services, may provide for the establishment of limits on the direct or indirect overall incurred costs or incurred costs of specific items or services or groups of items or services to be recognized as reasonable based on estimates of the costs necessary in the efficient delivery of needed health services to individuals covered by the insurance programs established under this subchapter, and may provide for the use of charges or a percentage of charges where this method reasonably reflects the costs. Such regulations shall (i) take into account both direct and indirect costs of providers of services (excluding therefrom any such costs, including standby costs, which are determined in accordance with regulations to be unnecessary in the efficient delivery of services covered by the insurance programs established under this subchapter) in order that, under the methods of determining costs, the necessary costs of efficiently deliv-

ering covered services to individuals covered by the insurance programs established by this subchapter will not be borne by individuals not so covered, and the costs with respect to individuals not so covered will not be borne by such insurance programs, and (ii) provide for the making of suitable retroactive corrective adjustments where, for a provider of services for any fiscal period, the aggregate reimbursement produced by the methods of determining costs proves to be either inadequate or excessive.

5. Pub. L. No. 92-603, § 223(b) (1972)—

The third sentence of section 1861(v)(1) of [the Social Security] Act is amended by striking out the comma after "services," where it last appears and inserting in lieu thereof the following: "may provide for the establishment of limits on the direct or indirect overall incurred costs or incurred costs of specific items or services or groups of items or services to be recognized as reasonable based on estimates of the costs necessary in the efficient delivery of needed health services to individuals covered by the insurance programs established under this title,".

6. 42 C.F.R. § 413.9(b)(1)—

(b) *Definitions*—(1) *Reasonable cost.* Reasonable cost of any services must be determined in accordance with regulations establishing the method or methods to be used, and the items to be included. The regulations in this part take into account both direct and indirect costs of providers of services. The objective is that under the methods of determining costs, the costs with respect to individuals covered by the program will not be borne by individuals not so covered, and the costs with respect to individuals not so covered will not be borne by the program. These regulations also provide for the making of suitable retroactive adjustments after the provider has submitted fiscal and statistical reports. The retroactive adjustment will represent the difference between the amount received by

the provider during the year for covered services from both Medicare and the beneficiaries and the amount determined in accordance with an accepted method of cost apportionment to be the actual cost of services furnished to beneficiaries during the year.

7. 42 C.F.R. § 413.30(a), (b)(3)—

(a) *Introduction*—(1) *Scope.* This section implements section 1861(v)(1)(A) of the Act, by setting forth the general rules under which HCFA may establish limits on provider costs recognized as reasonable in determining Medicare program payments. . . .

* * * * *

(2) *General principle.* Reimbursable provider costs may not exceed the costs estimated by HCFA to be necessary for the efficient delivery of needed health services. HCFA may establish estimated cost limits for direct or indirect overall costs or for costs of specific items or services or groups of items or services. These limits will be imposed prospectively and may be calculated on a a per admission, per discharge, per diem, per visit, or other basis.

(b) *Procedure for establishing limits.*

* * * * *

(3) Prior to the beginning of a cost period to which revised limits will be applied, HCFA will publish a notice in the Federal Register, establishing cost limits and explaining the basis on which they were calculated.

8. 42 C.F.R. § 413.64(a)(1), (b), (f)—

(a) *Principle*—(1) *Reimbursement on a reasonable cost basis.* Providers of services paid on the basis of the reasonable cost of services furnished to beneficiaries will receive interim payments approximating the actual costs of the provider. These payments will be made on the most expeditious schedule administratively feasible but not less

often than monthly. A retroactive adjustment based on actual costs will be made at the end of a reporting period.

* * * * *

(b) *Amount and frequency of payment.* Medicare states that providers of services will be paid the reasonable cost of services furnished to beneficiaries. Since actual costs of services cannot be determined until the end of the accounting period, the providers must be paid on an estimated cost basis during the year. While Medicare provides that interim payments will be made no less often than monthly, intermediaries are expected to make payments on the most expeditious basis administratively feasible. Whatever estimated cost basis is used for determining interim payments during the year, the intent is that the interim payments shall approximate actual costs as nearly as is practicable so that the retroactive adjustment based on actual costs will be as small as possible.

* * * * *

(f) *Retroactive adjustment.* (1) Medicare provides that providers of services will be paid amounts determined to be due, but not less often than monthly, with necessary adjustments due to previously made overpayments or underpayments. Interim payments are made on the basis of estimated costs. Actual costs reimbursable to a provider cannot be determined until the cost reports are filed and costs are verified. Therefore, a retroactive adjustment will be made at the end of the reporting period to bring the interim payments made to the provider during the period into agreement with the reimbursable amount payable to the provider for the services furnished to program beneficiaries during that period.

(2) In order to reimburse the provider as quickly as possible, an initial retroactive adjustment will be made as soon as the cost report is received. For this purpose, the costs will be accepted as reported, unless there are obvious errors or inconsistencies, subject to later audit. When an

audit is made and the final liability of the program is determined, a final adjustment will be made.

(3) To determine the retroactive adjustment, the amount of the provider's total allowable cost apportioned to the program for the reporting year is computed. This is the total amount of reimbursement the provider is due to receive from the program and the beneficiaries for covered services furnished during the reporting period. The total of the interim payments made by the program in the reporting year and the deductibles and coinsurance amounts receivable from beneficiaries is computed. The difference between the reimbursement due and the payments made is the amount of the retroactive adjustment.

No. 87-1097

In the Supreme Court of the United States

OCTOBER TERM, 1987

OTIS R. BOWEN, SECRETARY OF HEALTH AND HUMAN SERVICES, PETITIONER

v.

GEORGETOWN UNIVERSITY HOSPITAL, ET AL.

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE DISTRICT OF COLUMBIA CIRCUIT

REPLY MEMORANDUM FOR THE PETITIONER

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TABLE OF AUTHORITIES

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1. Respondents argue (Br. in Opp. 5-7) that review by this Court is unwarranted because this case is "unique"; they assert that the Secretary has for the "first and only time" attempted to use the rulemaking process to "reverse a lower court judgment" (Br. in Opp. 5). Respondents' contention rests upon a wholly distorted view of the issues in this case.

The Secretary's 1981 rule governing Medicare reimbursement for hospital wage costs was invalidated on procedural grounds in *District of Columbia Hospital Ass'n* v. *Heckler*, No. 82-2520 (D.D.C. Apr. 29, 1983). The district court in that case refused to issue an order barring the Secretary from applying the 1981 rule to respondents' reimbursement claims, holding that the provisions of the Medicare statute requiring exhaustion of administrative remedies deprived the court of the authority to issue such

an order. The court expressly stated that respondents' reimbursement claims were left to be adjudicated in the administrative process. Pet. App. 62a-64a. As its terms make clear (see *id.* at 64a), the 1983 order simply invalidated the 1981 rule; it did not address the Secretary's authority to (1) issue a new rule to govern the reimbursement question that would have been covered by the 1981 rule, and (2) apply any such new rule to respondents' reimbursement claims.

Indeed, respondents' argument here is identical to the argument that this Court rejected in *SEC* v. *Chenery Corp.*, 332 U.S. 194 (1947). Previously, in *SEC* v. *Chenery Corp.*, 318 U.S. 80 (1943), the Court had invalidated an order of the Securities and Exchange Commission imposing a condition on the approval of a utility reorganization plan and directed that the case be remanded to the Commission for further proceedings. The Commission on remand "reexamined the problem, recast its rationale and reached the same result" (332 U.S. at 196). The respondents argued before this Court that the Court's prior decision foreclosed the Commission from again reaching the same result. They contended that "the Commission would be free only to promulgate a general rule [imposing such conditions upon] utility reorganizations; but such a rule would have to be prospective in nature and have no retroactive effect upon the instant situation" (*id.* at 199-200).

This Court squarely rejected the respondents' argument. The Court stated that its prior decision held "no more and no less than that the Commission's first order was unsupportable for the reasons supplied by that agency. But when the case left this Court, the problem [addressed in the Commission's order] still lacked a final and complete answer" (332 U.S. at 200). The Court explained that "[t]he

fact that the Commission had committed a legal error in its first disposition of the case certainly gave [the respondents] no vested right to receive the benefits of [an order approving the reorganization without the condition]. * * * After the remand was made, therefore, the Commission was bound to deal with the problem afresh, performing the function delegated to it by Congress" (*id.* at 200-201). The Court went on to hold that retroactive application of the new legal rule was proper on the facts of that case (*id.* at 202-209).

Here, the district court's 1983 order did not finally decide the question of the appropriate standard to be applied in calculating wage cost reimbursement owed to respondents under the Medicare program. The district court's order, like this Court's order in the first *Chenery* case, simply rejected—on procedural grounds—one answer to that question. The Secretary retained his otherwise-existing authority to "deal with the problem afresh, performing the function delegated to [him] by Congress." The question in this case, therefore, is whether the Secretary's decision to apply the 1984 rule retroactively to cost reports that would have been governed by the 1981 rule falls within the rulemaking authority delegated to the Secretary by Congress. Like this Court's order in the first *Chenery* case, the district court's 1983 order is simply not relevant to that question.[1]

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[1] Respondents emphasize (Br. in Opp. 5) their contention that the Secretary seeks to recoup funds previously paid to respondents. First, contrary to respondents' assertion, respondents were not paid pursuant to a court order. They were paid pursuant to the Medicare cost reimbursement procedures, which were not the subject of the district court's order. And those payments were expressly made subject to reopening and recoupment in the event of an adjustment in

2. Respondents dispute our contention (Pet. 13-15) that there is a conflict among the courts of appeals with respect to the Secretary's authority to issue retroactive rules under Section 1861(v)(1)(A)(ii) of the Medicare Act, 42 U.S.C. (Supp. III) 1395x(v)(1)(A)(ii). Nevertheless, respondents appear to agree that the courts of appeals have reached differing conclusions about the meaning of this provision. Indeed, because those courts have themselves acknowledged the conflict (see Pet. 15 n.8), respondents would be hard-pressed to deny it. Respondents instead assert that the conflict is not presented in this case for two different reasons.

Respondents first observe that the present case involves a retroactive cost limit rule and argue (Br. in Opp. 15-16) that, because the decisions of the courts of appeals interpreting Section 1861(v)(1)(A)(ii) to authorize retroactive rules of general application were rendered in cases in which cost reimbursement rules of general application other than cost limit rules were at issue, those decisions are distinguishable from the present case. Respondents' distinction simply makes no sense. Nothing in the text of Section 1861(v)(1)(A)(ii) ties the scope of the Secretary's authority under that provision to the type of cost reimbursement standard to be applied retroactively. Section 1861(v)(1)(A)(ii) grants the Secretary the authority to promulgate regulations for "the making of suitable retroactive

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the amount of reimbursement as the result of the adoption of a new wage cost regulation. See, *e.g.*, Letter from R.M. Hugney to Robert B. Johnson (Jan. 31, 1984); 42 C.F.R. 405.1885.

Respondents express (Br. in Opp. 6-7) great surprise that the Secretary would choose to issue a new rule rather than appeal the district court's order. It surely is not a novel proposition that an administrative agency may decide to conduct a new rulemaking to cure a defect found by a district court instead of seeking appellate review of the adverse decision.

corrective adjustments" in reimbursement awards, without in any way limiting that retroactive authority to certain types of cost rules.

Simply put, Section 1861(v)(1)(A)(ii) does one of three things. Either it authorizes the Secretary to issue regulations of general application to be applied retroactively in individual reimbursement cases, or, as the court of appeals concluded, it is limited to empowering the Secretary to conduct a case-by-case reassessment of the reasonableness of particular reimbursement awards, or it authorizes a case-by-case reconciliation of advance estimated payments with the final reimbursement award. The statutory language does not admit of a distinction between different types of cost regulations. Since some courts have concluded that the statute permits the issuance of retroactive regulations of general application and other courts have concluded that it does not, there plainly is a conflict in interpretation warranting review by this Court. *E.g.*, compare *Springdale Convalescent Center* v. *Mathews*, 545 F.2d 943, 954 (5th Cir. 1977) (generally construing Section 1861(v)(1)(A)(ii) to authorize issuance of retroactive regulations) and *Tallahassee Memorial Regional Medical Center* v. *Bowen*, 815 F.2d 1435, 1453-1454 & n.36 (11th Cir. 1987), petition for cert. pending, No. 87-380 (applying balancing test to determine whether rule may be applied retroactively under Section 1861(v)(1)(A)(ii)) with Pet. App. 16a-19a (Section 1861(v)(1)(A)(ii) does not authorize issuance of retroactive rules of general application); see also Pet. 13-15.[2]

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[2] Respondents suggest (Br. in Opp. 9-11, 12) that what they refer to as "section 223(b)" independently bars the issuance of retroactive cost limit regulations. As an initial matter, we note that this is not a separate statute or even a separate section of the Medicare Act. It is simply a section of the 1972 amendments which adds a phrase to the

Indeed, the court below neither limited its construction of Section 1861(v)(1)(A)(ii) to the cost limit context nor relied upon any peculiar characteristic of cost limit rules to justify its conclusion about the limited scope of Section 1861(v)(1)(A)(ii) (see Pet. App. 16a-19a). The court's in-

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third sentence of Section 1861(v)(1) of the Medicare Act authorizing the issuance of cost limit rules (see Br. in Opp. App. 70(a)). In any event, as we explained in the petition (at 16-17), any restriction imposed by that provision is not applicable here. Respondents' contrary argument (Br. in Opp. 10-11) consists of the citation of statements that various cost limit rules would be prospective in effect; respondents cite no statement by the Secretary that the statute bars the issuance of a cost limit rule that is retrospective in the limited sense of the rule at issue here (see Pet. 11-13).

In any event, this purported distinction provides no aid to respondents' effort to explain away the conflicting decisions of the courts of appeals because no court has relied upon that alleged distinction in interpreting Section 1861(v)(1)(A)(ii) in the cost limit rule context. In *Mason General Hospital* v. *Secretary of Health & Human Services*, 809 F.2d 1220 (6th Cir. 1987), a case concerning the retroactivity of the Medicare malpractice insurance rule, which is not a cost limit rule, the court cited the legislative history of the cost limit provision relied upon by respondents and concluded that a balancing test should be used to determine whether a retroactive rule of general application may be issued under Section 1861(v)(1)(A)(ii) (see 809 F.2d at 1224-1226). The one court that has addressed respondents' contention has thus found that retroactive rules of general application may nonetheless in some circumstances be authorized by Section 1861(v)(1)(A)(ii).

Furthermore, as we discuss in our petition (at 14-15), some courts have concluded that Section 1861(v)(1)(A)(ii) does not permit any retroactive alteration in reimbursement standards, but simply authorizes the Secretary to carry out a bookkeeping reconciliation between advance estimated payments to a provider and the amount of reimbursement actually found to be owing to the provider. The distinction relied upon by respondents does not explain this division of opinion among the courts of appeals. Review of this question of statutory interpretation is therefore appropriate in this case.

terpretation of Section 1861(v)(1)(A)(ii) by its terms extends to all cost reimbursement standards, not just cost limit rules. Since the court below did not write the narrower opinion postulated by respondents, respondents have plainly failed to distinguish the conflicting decisions of the other courts of appeals.[3]

Respondents also assert (Br. in Opp. 16-17) that the decisions of the other courts of appeals upholding retroactive rules are distinguishable because those courts relied upon the "limited retroactivity" of the rules under review. But the court below did not hold Section 1861(v)(1)(A)(ii) inapplicable because of the degree of the rule's retroactivity; it concluded that the provision does not authorize *any* retroactive rules of general application. Moreover, as we discuss in our petition (at 11-12) the retroactivity of the rule at issue here was quite limited: the governing standard was published before it was placed into effect. Since the rule at issue here is therefore retroactive in a formal sense, but could not by its nature upset the reasonable expectations of entities subject to the rule, the decision below squarely conflicts with the decisions of the other courts of appeals.[4]

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[3] Moreover, respondents' own argument regarding the proper interpretation of Section 1861(v)(1)(A)(ii) does not distinguish between cost limit regulations and other types of regulations, but rather contends that the provision authorizes only case-by-case reexamination of reimbursement awards, not retroactive regulations of general application. See Br. in Opp. 12-14. Indeed, respondent appears to endorse an interpretation of Section 1861(v)(1)(A)(ii) more restrictive than that adopted by the court of appeals. Compare Br. in Opp. 13-14 with note 2, *supra*.

[4] We addressed in the petition (at 15-16 n.9) respondents' contention (Br. in Opp. 11) that the Secretary did not properly invoke Section 1861(v)(1)(A)(ii) to justify the promulgation of the rule at issue here.

3. Respondents argue (Br. in Opp. 19) that the question presented in the petition regarding the effect of the Administrative Procedure Act (APA) upon the Secretary's authority to issue retroactive rules is not properly raised in this case, but their contention ignores the opinion written by the court of appeals. Specifically, respondents contend that the Medicare statute itself prohibits the promulgation of a retroactive cost limit rule and that the Court therefore need not consider whether the APA also barred the issuance of the rule. But, as far as we are aware, no court has ever endorsed the contention that the Medicare statute bars the promulgation of retroactive cost limit rules. And the court below plainly did not rest its decision upon that ground; to the contrary, it held that the Medicare statute does not specifically authorize retroactive cost limit rules. In view of the considerable practical importance of the issue that the court of appeals *did* decide (see Pet. 24-25), respondents' assertions about the meaning of the Medicare statute provide no reason for this Court to decline to review that question. See also Pet. 16-17 (addressing argument that the Medicare statute bars retroactive cost limit rules); note 2, *supra* (same).

Respondents also list (Br. in Opp. 21-22) five facts that they assert distinguish the court of appeals' decision in this case from the decisions in which other courts of appeals have stated that the APA does not bar the issuance of retroactive rules. Unfortunately for respondents, none of these facts was relied upon by the court of appeals in the present case, and none of the other courts relied upon the absence of those facts in holding that retroactive rulemaking may be permissible. For that reason, they do not serve to distinguish the conflicting decisions of the other courts of appeals.[5]

[5] Respondents' disputation (Br. in Opp. 19-21, 23) about the merits of the APA issue merely confirms that there is a disagreement about an important issue of statutory construction warranting this Court's attention. We note that respondents fail to provide any reason why the APA should be interpreted to bar the adoption of rules having a retroactive effect when, as even the court of appeals recognized (see Pet. App. 11a-13a) the statute plainly permits retroactive application of new legal principles in the adjudicatory context. This is especially true when the language of the statute and its legislative history plainly point to the conclusion that retroactive rules are permissible in appropriate circumstances (see Pet. 19-22).

4. a. Respondents do not dispute that the question presented regarding the court of appeals' construction of the APA is an issue of considerable practical importance. See Pet. 24-25 (discussing importance of the APA issue). They do argue, however, that the question regarding the proper construction of Section 1861(v)(1)(A)(ii) has no continuing importance. But Medicare cost reimbursement rules are applied on an ongoing basis to a large number of providers of health services (see Pet. 23-24). Respondents themselves concede that cost limit rules currently apply to a variety of providers (the Department of Health and Human Services informs us that these providers receive more than $3 billion in reimbursement annually); and respondents' statement that no such rules currently apply to hospitals does not mean that such rules may not be adopted in the future. Finally, as we have discussed, the question presented regarding the scope of Section 1861(v)(1)(A)(ii) is not restricted to cost limit rules; the same statute governs the Secretary's authority to adopt other retroactive cost reimbursement rules. The court of appeals has thus limited the Secretary's authority to administer a program involving a substantial amount of federal resources. This issue is therefore of sufficient importance to warrant this Court's attention. See *Bethesda Hospital Ass'n* v. *Bowen*, cert. granted, No. 86-1764 (Oct. 5, 1987) (case in which the Court recently granted cer-

tiorari to consider another question involving the Medicare cost reimbursement system).[6]

b. Respondents also assert (Br. in Opp. 23-25) that the court of appeals' judgment can be supported on a variety of alternative grounds. Respondents will, of course, be free to raise before this Court any alternative arguments presented below. In view of the importance of the questions decided by the court of appeals, however, these alternative arguments should not deter the Court from granting review in this case.[7]

For the foregoing reasons, and the reasons stated in the petition, it is respectfully submitted that the petition for a writ of certiorari should be granted.

DONALD B. AYER*
Acting Solicitor General

FEBRUARY 1988

[6] Respondents question (Br. in Opp. 18-19) our statement that many pending cases involve challenges to the Secretary's authority to promulgate retroactive cost limit regulations (see Pet. 24. n.15). We were referring to the several hundred cases involving challenges to the retroactive medical malpractice reimbursement rule which, although they technically do not involve a cost limit regulation, present virtually the same question regarding the scope of Section 1861(v)(1)(A)(ii) as the present case. The Secretary has issued a settlement offer with respect to these cases, but it is not possible to determine whether the offer will be accepted by any of the many thousands of parties to those cases.

[7] Only one of these arguments was considered by either of the courts below. As we discuss in the petition (at 22-23 n.13), the district court plainly erred by concluding that retroactive application of the 1984 rule was impermissible under the balancing test set forth in *Retail, Wholesale & Dep't Store Union* v. *NLRB*, 466 F.2d 380 (D.C. Cir. 1972).

* The Solicitor General is disqualified in this case.

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(4)

No. 87-1097

In the Supreme Court of the United States

OCTOBER TERM, 1987

OTIS R. BOWEN, SECRETARY OF HEALTH AND HUMAN SERVICES, PETITIONER

v.

GEORGETOWN UNIVERSITY HOSPITAL, ET AL.

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE DISTRICT OF COLUMBIA CIRCUIT

JOINT APPENDIX

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PETITION FOR A WRIT OF CERTIORARI FILED DECEMBER 30, 1987
CERTIORARI GRANTED FEBRUARY 29, 1988

82 pp

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JOINT APPENDIX

TABLE OF CONTENTS*

* The opinion, judgment, and orders of the court of appeals and opinion and order of the district court are printed in the appendix to the petition for a writ of certiorari and have not been reproduced here.

CONTENTS – Continued

UNITED STATES COURT OF APPEALS
FOR THE DISTRICT OF COLUMBIA CIRCUIT

Nos. 86-5381, 86-5382, 86-5383
(consolidated cases)

RELEVANT DOCKET ENTRIES

Date	Filings – Proceedings
(B)06-20-86	Copy of notice of appeal and docket entries from Clerk, DC (n-2)
(R)06-23-86	Notice from Clerk, DC re: Motion by deft. to continue stay, pending appeal of the Court's Order dated 4-11-86 [15].
(R)07-01-86	Notice from Clerk, DC re: order filed 6-24-86 [15].
(R)09-16-86	5 – Appellant's motion to consolidate case #86-5381, 86-5382 and 86-5383 (m-16) [13].
(E)09-25-86	The motion to consolidate is granted.
(R)10-22-86	15 – APPELLANT'S BRIEF (m-22) 35.5.
(R)10-22-86	7 – APPELLANT'S APPENDIX (m-22).
(X)01-16-87	16 – APPELLEES' BRIEF (p-16) (25).
(X)02-20-87	15 – APPELLANT'S REPLY BRIEF (m-20) (25).
(W)03-12-87	CERTIFIED ORIGINAL RECORD, 1 Volume, 1 Reporters Transcript under 1 cover, 1 Administrative Record to #7

Date	Filings – Proceedings
	in Brown Folder and Supplemental Record #30 Notice of Filing – *Placed Under Seal* in 2 brown envelopes.
(X)03-24-87	15 – APPELLEES' SUPPLEMENTAL BRIEF (m23) (25).
(W)03-30-87	ARGUED before Edwards, Starr, CJs and Luther M. Swygert, Senior Circuit Judge, U.S. Court of Appeals for the Seventh Circuit. [Bin #54-2].
(X)03-31-87	5 – Letter from counsel for appellant advising of additional authorities pursuant to FRAP 28(j) (m-31) (25).
(X)04-03-87	5 – Letter from counsel for appellee in response to appellant's letter dated 3/31/87 (p-3) (25).
(X)04-21-87	5 – Letter from counsel for appellee advising of additional authorities pursuant to FRAP 28(j) (p-21) (25).
(X)05-13-87	5 – Letter from counsel for appellee advising of additional authorities pursuant to FRAP 28(j) (p-13) (25).
(X)05-14-87	4 – Corrected letter from counsel for appellee advising of additional authorities pursuant to FRAP 28(j) (p-13) (25).
(X)06-02-87	5 – Letter from counsel for appellant advising of additional authorities pursuant to FRAP 28(j) (p-2) (25).
(X)06-08-87	5 – Letter from counsel for appellee in response to 28(j) letter filed 6/2/87 (p-8) (25).

Date	Filings – Proceedings
(X)06-09-87	5 – Letter from counsel for appellant advising of additional authorities pursuant to FRAP 28(j) (p-9) (25).
(X)06-10-87	5 – Letter from counsel for appellee in response to 28(j) letter filed 6/9/87 (p-10) (25).
(X)06-24-87	5 – Letter from counsel for appellant advising of additional authorities pursuant to FRAP 28(j) (p-24) (25).
(D)06-26-87	Opinion for the Court filed by Circuit Judge Edwards.
(D)06-26-87	Judgment by this Court that the judgement of the District Court appealed from in these causes is hereby affirmed, in accordance with the Opinion for the Court filed herein this date.
(D)06-26-87	Mandate order.
(R)07-10-87	5 – Appellee's bill of costs (m-10) [9].
(R)08-10-87	20 – Appellant's petition for rehearing and suggestion for rehearing en banc (m-10) [1].
(J)09-01-07	Per Curiam order denying appellant's petition for rehearing. Edwards, Starr, CJs and Sygert, SCJ, U.S. Court of Appeals for the Seventh Circuit.
(J)09-01-87	Per Curiam order en banc denying appellant's suggestion for rehearing en banc. CJ Wald, Robinson, Mikva, Edwards, Ruth B. Ginsburg, Bork, Starr, Silberman, Buckley, Williams and D.H. Ginsburg, and Swygert, SCJ, U.S. Court of Appeals for the Seventh Circuit.

Date	Filings – Proceedings
(D)10-05-87	MANDATE ISSUED. Costs are awarded to appellees in the amount of $265.85 and taxed against Otis R. Bowen, Secretary of HHS.
(R)01-12-88	Notice from Clerk, Supreme Court advising that petition for certiorari was filed in Supreme Court #87-1097 on 12-30-87 [1].

UNITED STATES DISTRICT COURT FOR
THE DISTRICT OF COLUMBIA

No. 85-1845

GEORGETOWN UNIVERSITY HOSPITAL, ET AL.,
PLAINTIFFS

v.

HECKLER, DEFENDANT

RELEVANT DOCKET ENTRIES

Date	NR	Proceedings
1985		
June 6	1	COMPLAINT; appearance. (br)
June 6		SUMMONS (1) issued.
Aug. 5	6	ANSWER by deft. to complaint. (br.)
Aug. 5	7	NOTICE of Filing by deft.; ADMINISTRATIVE RECORD: (3 vols). (br.)
Aug. 7		CALENDERED. CD/N. (br.)
Aug. 19	9	MOTION by plntfs to compel (filed 8/16/86); memo; exhibit 1-4. (hls)
Sept. 5	11	MEMORANDUM by dft in opposition to plntfs' motion to compel; exhibit A-C. (hls)
Sep. 13	12	REPLY by plntfs. to deft's opposition to plntfs.' motion to compel. (df).
Sep. 20	13	RESPONSE by deft. to the Court's suggestion that the withheld documents be submitted to the Court and placed under seal, or in the alternative, that

Date	NR	Proceedings
		such records be retained by deft. under court order. (df)
Sep. 27	14	MEMORANDUM filed 9-23-85 (signed 9-22-85) (N). OBERDORFER, J. (df)
Sep. 27	15	ORDER filed 9-23-85 directing deft. file by 9-30-85 under seal all documents listed in administrative record in Sutter v. Dept. of Health and Human Services, No. 85-1118; directing parties file dispositive motions by 10-21-85; directing responses to motions be filed by 11-4-85. (signed 7-22-85) (N). OBERDORFER, J. (df)
Oct. 4	29	FILING of documents under seal by deft; attachment. (hls)
Oct. 4	30	NOTICE by deft of filing; declaration of Henry Desmarais, MD; attachments; (filed under seal-vault 1800, 2 vols). (hls)
Oct. 21	32	MOTION by pltfs for summary judgment; statement of material facts; memo; table of contents; exhibits 1-7. (hls)
Oct. 21	33	MOTION by deft for summary judgment; P&A; table of contents; table of authorities. (hls)
Nov. 4	35	ORDER consolidating CA 85-2545, 85-2862, WITH 85-1845. (hs)
Nov. 12	36	DEFT'S reply brief. (hls)

Date	NR	Proceedings
Nov. 12	37	MEMORANDUM of pltfs in opposition to deft's motion for summary judgment and in further support of pltfs' motion for summary judgment; table of contents; table of authorities; Exhibits 11 thru 13. (io).
Nov. 18		CROSS MOTIONS for summary judgment argued and taken under advisement. (Rep: T. Dourian) Oberdorfer, J. (io)
Dec. 2	38	POST-HEARING MEMORANDUM of pltfs; Exhibits 1 thru 48; (Rep: Thomas Dourian) (io)
Dec. 16	39	TRANSCRIPT OF PROCEEDINGS from 11-18-85; pages 1 thru 48; (Rep: Thomas Dourian) (io)
Dec. 18	40	RESPONSE of deft to pltfs' post hearing memorandum. (io)
1986		
Apr. 14	41	MEMORANDUM (filed 4-11-86). (N) Oberdorfer, J. (io)
Apr. 14	42	ORDER filed 4-11-86 granting pltfs' motion for summary judgment; denying deft's motion for summary judgment; and directing that on or before 4-25-86 deft pay to pltfs amounts previously recouped from pltfs, plus interest. (N) Oberdorfer, J. (io)
Apr. 24	46	ORDER granting deft's motion to stay Court's order of 4-11-86; staying

Date	NR	Proceedings
		Court's order and judgment of 4-11-86 until ten (10) days after the period of time for filing of notice of appeal is exhausted. (N) Oberdorfer, J. (io)
June 6	47	NOTICE OF APPEAL by deft Otis R. Bowen, M.D. from order entered 4-11-86. No fee paid, U.S. Government. Copies mailed to: Ronald N. Sutter. (io)
June 11		PRELIMINARY RECORD transmitted to USCA; USCA #86-5381. (io)
June 30	49	ORDER filed 6-24-86 staying Court's Order & Judgment of 4-11-86 until ten (10) days after appeal is resolved. (N) USCA/N Oberdorfer, J.

UNITED STATES DISTRICT COURT FOR THE DISTRICT OF COLUMBIA

No. 85-2545

HOWARD UNIVERSITY, ET AL., PLAINTIFFS

v.

HECKLER, DEFENDANT

RELEVANT DOCKET ENTRIES

Date	NR	Proceedings
1985		
Aug. 9	1	COMPLAINT, appearance. (sl)
Aug. 9		SUMMONS (3) issued. (sl)
Oct. 9	2	ANSWER by deft to complaint. (hls)
Oct. 11	3	NOTICE by deft of filing of administrative record. (hls)
Oct. 17		CALENDERED. CD/N (hls)
Oct. 21	5	MOTION by pltfs for summary judgment. (hls)
Nov. 1		STATUS CALL: oral motion of pltf to consolidated CA 85-1845 and CA 85-2862 with CA 2545 argued and granted.
Nov. 6	6	MOTION by deft for summary judgment. (hls)
Nov. 4	7	ORDER consolidating CA 85-2545, 85-2862 with 85-1845. (hls)

Date	NR	Proceedings
Nov. 12		MEMORANDUM of pltfs in opposition to deft's motion for summary judgment and in further support of pltfs' motion for summary judgment; table of contents; table of authorities; Exhibits 11 thru 13. (filed in 85-1845) (io)
Nov. 18		CROSS MOTIONS for summary judgment argued and taken under advisement (Rep: Tom Dourian) Oberdorfer, J. (io)
Dec. 2		POST-HEARING MEMORANDUM of pltfs; Exhibits 1 thru 3. (filed in 85-1845) (io)
Dec. 16		TRANSCRIPT OF PROCEEDINGS from 11-18-85; pages 1 thru 48; (Rep: Thomas Dourian) filed in 85-1845) (io)
1986		
Apr. 14	8	MEMORANDUM (filed 4-11-86). (N) Oberdorfer, J. (Orig. filed in 85-1845) (io)
Apr. 14	9	ORDER filed 4-11-86 granting pltfs' motion for summary judgment; denying deft's motion for summary judgment; and directing that on or before 4-25-86 deft pay to plfts amount previously recouped from pltfs, plus interest. (N) Oberdorfer, J. (Orig. filed in 85-1845) (io)
Apr. 24	10	ORDER granting deft's motion to stay Court's order of 4-11-86; staying Court's order and judgment of 4-11-86 until ten (10) days after the period of time for filing of notice of appeal is exhausted. (N) Oberdorfer, J. (Orig. filed in 85-1845) (io)
Jun. 6	11	NOTICE OF APPEALS by deft Otis R. Bowen, M.D. from order entered 4-11-86. No fee paid, U.S. Government. Copies mailed to: Ronald N. Sutter. (io)
Jun. 11		PRELIMINARY RECORD transmitted to USCA; #86-5382. (io)
Jun. 30		ORDER filed 6-24-86 staying Court's Order & Judgment of 4-11-86 until ten (10) days after appeal is resolved. (N) (USCA.N) (filed in CA 85-1845) Oberdorfer, J. (1a)

UNITED STATES DISTRICT COURT FOR THE DISTRICT OF COLUMBIA

No. 85-2862

TUCSON GENERAL HOSPITAL, PLAINTIFF

v.

HECKLER, DEFENDANT

RELEVANT DOCKET ENTRIES

Date	NR	Proceedings
1985		
Sept. 9	1	COMPLAINT; appearance; Attachment. (mao)
Sept. 9		SUMMONS (3) issued. (mao)
Oct. 21	2	MOTION by pltf. for summary judgment. (ks)
Nov. 6	3	ANSWER by deft. to the complaint. (ks)
Nov. 6	4	NOTICE by deft. of filing the Administrative Record. (ks)
Nov. 6	5	MOTION by deft. for summary judgment. (ks)
Nov. 15	6	ORDER FILED 11-4-85 consolidating CA 85-2545 and CA 85-2862 with CA 85-1845. (ks)
Nov. 12		MEMORANDUM of pltfs in opposition to deft's motion for summary judgment and in further support of pltfs' motion for summary judgment;

Date	NR	Proceedings
		table of contents; table of authorities; Exhibits 11 thru 13. (filed in 85-1845) (io)
Nov. 18		CROSS MOTIONS for summary judgment argued and taken under advisement. (Rep. T. Dourian) Oberdorfer, J. (io)
Dec. 2		POST-HEARING MEMORANDUM of pltfs; Exhibits 1 thru 3. (filed in 85-1845) (io)
Dec. 16		TRANSCRIPT OF PROCEEDINGS from 11-18-85; pages 1 thru 48; (Rep: Thomas Dourian) (filed in 85-1845) (io)
1986		
Apr. 14	7	MEMORANDUM (filed 4-11-86). (N) Oberdorfer, J. (Orig. filed in 85-1845)
Apr. 14	8	ORDER filed 4-11-86 granting pltfs' motion for summary judgment; and directing that on or before 4-25-86 deft pay to pltfs amounts previously recouped from pltfs, plus interest. (N) Oberdorfer, J. (Orig. filed in 85-1845) (io)
Apr. 24	9	ORDER granting deft's motion to stay Court's order of 4-11-86; staying Court's order and judgment of 4-11-86 until ten (10) days after the period of time for filing of notice of appeal is exhausted. (N) Oberdorfer, J. (Orig. filed in 85-1845) (io)

Date	NR	Proceedings
Jun. 6	10	NOTICE OF APPEALS by deft Otis R. Bowen, M.D. from order entered 4-11-86. No fee paid, U.S. Government. Copies mailed to: Ronald N. Sutter. (io)
Jun. 11		PRELIMINARY RECORD transmitted to USCA; USCA #86-5383. (io)
Jun. 30		ORDER filed 6-24-86 staying Court's Order & Judgment of 4-11-86 until ten (10) days after appeal is resolved. (N) (USCA/N (filed in CA 85-1845) Oberdorfer, J. (1a)

49 Fed. Reg. 6175-6180 (1984)

Health Care Financing Administration

Medicare Program; Reissuance of the Wage Index in the 1981 Schedule of Limits on Hospital Per Diem Inpatient General Routine Operating Costs

AGENCY: Health Care Financing Administration (HCFA), HHS.

ACTION: Proposed notice.

SUMMARY: We are reissuing for public comment the change in the types of data that were used to calculate the wage index that was contained in the schedules of limits on hospital per diem inpatient general routine operating costs reimbursable under Medicare that were applicable to cost reporting periods beginning on or after July 1, 1981 and for cost reporting periods ending after September 30, 1981. The cost limits for cost reporting periods beginning on or after October 1, 1982 are governed by the notice published in the **Federal Register** on September 30, 1982 (47 FR 43296) and August 30, 1983 (48 FR 39426) and are not affected by this reissuance. The wage index was originally issued as part of the schedule of limits published on June 30, 1981 (46 FR 33637) and September 30, 1981 (46 FR 48010) and is being reissued as the result of the April 29, 1983 decision of the United States District Court for the District of Columbia in the case of *District of Columbia Hospital Association, et al. v. Heckler, et al.* (No. 82-2520 DDC). The District Court held that the 1981 schedule of hospital cost limits was invalid for failure to comply with the Administrative Procedure Act insofar as the schedule incorporated or was formulated by using a wage index that was calculated by excluding Federal government hospital wage data.

DATES: To assure consideration comments must be received by March 19, 1984.

ADDRESS: Address comments in writing to: Health Care Financing Administration, Department of Health and Human Services, Attention: BERC-276-P, P.O. Box 26676, Baltimore, Maryland 21207.

If you prefer, you may deliver your comments to Room 309-G Hubert H. Humphrey Building, 200 Independence Ave., SW., Washington, D.C., or to Room 132, East Hight Rise Building, 6325 Security Boulevard, Baltimore, Maryland 21207. In commenting, please refer to BERC-276-P.

Comments will be available for public inspection as they are received, beginning approximately three weeks from today, in Room 309-G of the Department's offices at 200 Independence Ave., SW., Washington, D.C. 20201, on Monday through Friday of each week from 8:30 a.m. to 5:00 p.m. (Phone: 202-245-7890)

FOR FURTHER INFORMATION CONTACT:
Marilyn Koch, 301-594-9343.

SUPPLEMENTARY INFORMATION:

I. Background

Section 1861(v)(1) of the Social Security Act (42 U.S.C. 1395x(v)(1)) as amended by Section 223 of Pub. L. 92-603, the Social Security Amendments of 1972, authorizes the Secretary to set prospective limits on the costs that are reimbursed under Medicare. These limits may be applied to direct or indirect overall costs or to costs incurred for specific items or services furnished by a Medicare provider, and may be based on estimates of the cost necessary for the efficient delivery of needed health services.

Regulations implementing this authority are set forth at 42 CFR 405.460. Under this authority, we published limits on hospital per diem inpatient general routine service costs

annually from 1974 through 1978, and limits on hospital per diem inpatient general routine operating costs in 1979, 1980, and 1981.

On June 30, 1981, we published in the **Federal Register** (46 FR 33637) a schedule of limits on hospital per diem inpatient general routine operating costs applicable to cost reporting periods beginning on or after July 1, 1981. A revised schedule of limits incorporating changes made by the Omnibus Budget Reconciliation Act of 1981 (Pub. L. 96-499) was published on September 30, 1981, (46 FR 48010), effective for cost reporting periods ending after September 30, 1981. For cost reporting periods that began before October 1, 1981, the limits in the September 30, 1981 notice applied only to the portion of the cost reporting period that occurred after September 30, 1981. In these notices, we described the scope of the cost limits and explained our methodology for deriving and applying the limits.

The June 30, 1981, notice (46 FR 33637) was published as a final notice without a prior notice and comment period. In the preamble to that notice, we stated that "in developing the revised limits, we followed the same methodology we used to develop the current limits," except for "minor technical changes in the types of data we used to calculate the wage index and the market basket values." The preamble went on to state that data from Federal government hospitals were excluded from the wage index to improve the accuracy of the wage index adjustment because Federal hospitals typically use national pay scales that do not necessarily reflect area wage levels (46 FR 33699). We determined that, while this wage adjustment would negatively affect only a few hospitals in only a relatively few standard metropolitan statistical areas (SMSAs), it would prevent an unwarranted distribution of public funds to certain hospitals and also prevent

the distorting effect of Federal wage scales on the entire wage index. Thus, we determined that use of the notice and comment procedures of the Administrative Procedure Act (APA) with respect to the calculation of the wage index was both unnecessary and contrary to the public interest. We therefore concluded that under the good cause exceptin of 5 U.S.C. 553(b)(B) of the APA, there was adequate justification to waive these procedures.

On April 29, 1983, the District Court for the District of Columbia in the case of *District of Columbia Hospital Association, et al v. Heckler, et al* (No. 82-2520 DDC) declared the exclusion of Federal hospital wage data from the wage index without prior notice and comment to be a violation of the APA. The court declared invalid the 1981 hospital cost limit schedule insofar as it incorporated or was formulated by using a hospital wage index that excluded Federal government hospital data. As part of this decision on April 29, 1983, the District Court for the District of Columbia ordered us to publish a notice in the **Federal Register** stating that the 1981 schedule of hospital cost limits had been declared invalid with respect to the wage index. We published this notice in the **Federal Register** on September 2, 1983 (48 FR 39998).

The purpose of the reissuance of the wage index as set forth below, is to seek public comments solely on the exclusion of Federal government hospital wage data from the index. All other aspects of the cost limit methodology, as published in the June 30, 1981 (46 FR 33637) and September 30, 1981 (46 FR 48010) notices, remain in effect and unchanged.

II. Explanation of the Wage Index Methodology

The use of the wage index as one component in the setting of cost limits was first introduced in 1979 to replace

per capita income as an indicator of area variations in wage levels. In developing the cost limit schedules for the June 30, 1981 and September 30, 1981 notices, we used a hospital wage index to reflect area-by-area differences in the labor-related component of hospital costs (wages and salaries, employee benefits, professional fees, costs of business services, and other miscellaneous expenses). We developed this index from hospital wage data obtained from the Bureau of Labor Statistics (BLS). The data used are those for the "hospital industry," a standard BLS reporting category. The wage index we used for the limits in the June 30, 1981 and September 30, 1981 notices was based on data for calendar year 1979, which were the lastest available data. We have used the same data for this proposed reissued wage index.

To calculate this index, we first computed the average hospital wage for each Standard Metropolitan Statistical Area (SMSA) or New England County Metropolitan Area (NECMA) and non-SMSA/non-NECMA. We then calculated the national average hospital wages for all SMSAs or NECMAs, and a separate national average hospital wage for all non-SMSAs/non-NECMAs. We then divided the average wage level for each area by the appropriate national average (SMSA/NECMA or non-SMSA/non-NECMA). These calculations resulted in an index value for each SMSA or NECMA that reflects the wage level for that area relative to the national average for all SMSAs/NECMAs, and an index value for each non-SMSA/non-NECMA that reflects the wage level for that area relative to the national average for all non-SMSAs/non-NECMAs (see Table 1A and 1B).

In addition to being based on more current data, the wage index we used in the June 30, 1981 and September 30, 1981 notices differed in two ways from the wage index used in developing the 1980 hospital cost limits. First, we

used approximate rather than actual index values for 26 areas. (These approximate values are identified by asterisks in Table IA). We made this change because the BLS, which supplies the data on wages and numbers of employees that we use to calculate the wage index, informed us that its confidentiality requirements prohibited it from disclosing actual data for areas that included fewer than three reporting units. (A reporting unit need not have been a single hospital. Reporting unit was (and is currently) defined by the BLS as the smallest unit for which data are recorded on the employer's contribution report. For example, two facilities in the same area owned by one employer could have appeared as one reporting unit.)

To make it possible to calculate limits for these areas, we asked the BLS to identify the areas having wage index values numerically closest to, but not less than, the areas for which it could not supply actual data. In the case of each area for which actual data were unavailable, we substituted the wage index value identified by the BLS as being closest to the actual value. We stated our belief that the use of approximate rather than actual values for these areas would not affect the accuracy of the limit significantly, and would assure that no hospital's limit was reduced because actual data for its areas were unavailable.

Second, in developing the wage index used for the limits in the June 30, 1981 and September 30, 1981 notices, we excluded data from Federal government hospitals. In this proposed reissuance of the 1981 wage index, we are continuing to exclude data from Federal hospitals from the wage data.

As a result of prior schedules that were issued, we received correspondence concerning the inequity of including Federal hospital wages in developing the wage index. We examined this issue and found that including Federal hospital wages resulted in wage index values that

were unrealistically low in areas without Federal hospitals in comparison to adjacent areas with Federal hospitals. The reason for this is that including Federal hospital wages in the data raises the national average hospital wage for all SMSAs/NECMAs and the national average hospital wage for all non-SMSAs/non-NECMAs. However, in determining the wage index for an adjacent area, the area's average wage would be divided by this higher national average resulting in a lower wage index. Yet these adjacent areas with an unrealistically low wage index were competing for the same employees as those areas whose only difference in average wages was the fact that a Federal hospital was located in the SMSA or non-SMSA. Including Federal hospital wage data resulted in wage indexes that did not reflect the differences in wages from area to area. Therefore, in order to correct this inaccuracy, we excluded Federal hospital data from the 1981 wage index.

The exclusion of Federal hospital data is technical in nature. It is designed to improve the accuracy of the wage index so that the index accurately reflects actual differences in wages from one area to another area. It is the purpose of hospital limits to ensure that the Medicare program reimburses providers only for those costs necessary in the efficient delivery of needed health services (42 U.S.C. 1395x(v)(1)(A)). The hospital wage index is but one component of the methodology used to establish limits on hospital inpatient routine operating costs. The wage index serves to reflect area-by-area differences in the labor related component of hospital costs. The more accurate the wage index, the more accurately it reflects these area-by-area differences and thus, ultimately, the more accurate the cost limits. In turn, this means that in accordance with Congressional intent, reimbursement is limited to those costs necessary in the efficient delivery of services.

Therefore, we believe that in 1981 we were correct in improving the accuracy of the hospital wage index by excluding the wage data of Federal government hospitals. We concluded that the exclusion of Federal government hospital data would improve the accuracy of the wage index because most Federal hospitals characteristically employ physicians and other high salaried professionals whose salaries are based on national rather than local wage scales. This factor tends to overstate the average hospital wage in areas with Federal institutions as compared to areas without such Federal facilities. Since the purpose of the wage index is to reflect area-by-area differences in the labor-related component of hospital costs, the exclusion of Federal hospital data better enables the wage index to accurately reflect area-by-area labor-related costs.

To the extent hospitals must pay employees wage rates similar to those of Federal facilities to attract qualified personnel, this competitive behavior is reflected in the non-Federal BLS data used to calculate the wage index. That is, if non-Federal hospitals in an area pay wage rates relatively equivalent with those of Federal hospitals, the exclusion of Federal wages would have little effect on the wage index. If wages paid to Federal hospital employees are higher than most area hospital wage levels, then the inclusion of Federal data results in most hospitals receiving a higher Medicare cost limit than is warranted based on their expected costs. Such a result defeats the purpose of the cost limits, which is to limit a provider's reimbursement to only those costs necessary in the efficient delivery of needed health services. Therefore, reissuance of the wage index excluding Federal hospital data reflects Congressional intent to limit hospital reimbursement to those costs necessary in the efficient delivery of services.

The reissuance of the wage index excluding Federal hospital data also avoids placing an unwarranted hardship and burden on intermediaries and many hospitals, while it would impose only a minimal burden on a few hospitals. The inclusion of Federal data in the wage index at this point in time would result in overpayments to many hospitals. As explained previously if we were to include Federal data now, we would have to recompute the national average hospital wage for all SMSAs or NECMAs and the national average hospital wage for all non-SMSAs/non-NECMAs. Both of these averages would be higher if the Federal hospital wage data were included. If the average wage level in an area without Federal hospitals were divided by the recomputed higher national average hospital wage, a lower wage index would result for that area. In this case, we would instruct the intermediaries to recompute the cost limits for those hospitals in areas with revised wage indexes and to recoup any overpayments that would result from the recomputation of the cost limits. We realize that this would create a hardship and burden on both hospitals and intermediaries. Intermediaries would have to review and revise already settled cost reports and reissue notices of program reimbursement (NPRs). Hospitals would be faced with overpayments as the result of these revised cost reports and may have to borrow money to repay the government. In contrast, those few hospitals that would receive less reimbursement if Federal hospital data are excluded from the wage index would not be unduly harmed or burdened by the reissuance of the wage index since these hospitals could only have relied on the wage index as published on June 30, 1981 and September 30, 1981 for reimbursement purposes. Since these limits are prospectively established and published in advance, all hospitals knew before the beginning of their respective cost reporting periods what their cost limit

would be. No hospital could have reasonably relied on a wage index that included Federal hospital data after the June 30, 1981 **Federal Register** notice. No hospital nor intermediary would be unduly harmed by this reissuance of the wage index. This proposed notice would simply put the previously set cost limits back into effect.

In summary, we believe that the exclusion of Federal hospital data from the wage index more accurately reflects actual hospital experience. We wish to note that the data used to develop the wage index were supplied by the BLS, and are the most reliable data available: All hospitals are required under State unemployment compensation laws to report these data. If we discover that we or the BLS have made an error based on data received from hospitals that results in an incorrect wage index for any area, we will publish corrected indexes in the **Federal Register** and will direct the Medicare intermediaries to recalculate the limits. However, the BLS has advised us that they are unable to correct any inaccuracies in the wage index that may result from a hospital's failure to report the required wage data.

It should be noted that from the time the original notice was published on June 30, 1981, BLS has advised us of various reporting errors in the wage and employment data. In addition on June 19, 1981, the Office of Management and Budget (OMB) announced the designation of new SMSAs and NECMAs as well as revisions in the metropolitan classifications based on the results of the 1980 census. We have issued instructions to the intermediaries advising them of these changes. However, in those situations where the corrected data resulted in a lower wage indexes for an area, we continued to use the higher wage index. The wage index which are shown in Tables I-A and I-B reflect the corrections that have been made since June 30, 1981.

III. Impact Analyses

A. Executive Order 12291 and Regulatory Flexibility Act

Executive Order 12291 requires us to prepare and publish a regulatory impact analyses for any regulations that are likely to have an annual effect on the economy of $100 million or more, cause a major increase in costs or prices, or meet other threshold criteria that are specified in that order. In addition, the Regulatory Flexibility Act (Pub. L. 96-354) requires us to prepare and publish a regulatory flexibility analyses for regulations unless the Secretary certifies that the regulations will not have a significant economic impact on a substantial number of small entities. (For purposes of the Regulatory Flexibility Act, small entities include all nonprofit and most for-profit hospitals.) Under both the Executive Order and the Regulatory Flexibility Act, such analyses must, when prepared, show that the agency issuing the regulations has examined alternatives that might minimize unnecessary burden or otherwise ensure the regulations to be cost-effective.

We have determined that this proposed notice, if implemented, would not meet the criteria of either E.O. 12291 or the Regulatory Flexibility Act. We considered two alternatives:

- To republish area wage indexes calculated as published in [illegible] with no change in methodology; or
- To [illegible]sh area wage indexes recalculated to incorporate Federal hospitals in the base data.

In the process of reviewing these alternatives, we considered their comparative impacts on hospital cost reporting periods subject to the cost limits published in 1981. We found that if we included Federal hospitals in the area wage index determinations, we would have to recalculate

both urban SMSAs/NECMAs and rural national average hospital wage levels, as well as the means used to determine the per diem limits for each group (published as Tables I and II in the 1981 notices). This would affect the limit for every hospital subject to the limits, although only to a relatively small degree. The limits for some groups would increase, while the limits for other groups would decrease.

The effect on a particular hospital would be the result of multiplying the per diem limit for the hospital's group by the hospital's revised area wage index. If both the limit and index for a hospital increased or decreased, the effect would of course be mutiplied, while if they moved in opposite directions, the changes would tend to cancel out.

We determined that the net effect on overall program expenditures would be relatively small, due to the tendency of increases and decreases in limits and indexes to cancel each other out in the aggregate. A change of area wage indexes to incorporate Federal hospitals in the base data would have the primary effect of redistributing marginal advantages and disadvantages. However, if Federal wages were included, more hospitals would be adversely affected, although the impact on the majority of individual hospitals would be relatively small. Including Federal hospital wage data would benefit those few hospitals located in an area with Federal hospital employees. We estimate that very few hospitals would have their annual reimbursement affected by more than $5,000. In the aggregate, the reissuance of wage indexes excluding Federal hospitals would result in smaller net disadvantage to hospitals as a whole, and is more cost beneficial to the hospitals.

Since the use of the wage index methodology as initially published in 1981 does not meet any of the criteria for identifying a major rule under E.O. 12291, we have determined that this notice is not a major rule and that a regulatory impact analysis is not required. In addition, the Secretary certifies under section 603(b) of the Regulatory Flexibility Act, that this notice will not result in a significant economic impact on a substantial number of small entities, and that a regulatory flexibility analysis is not required.

B. Paperwork Burden

This notice contains no information collection requirements, and therefore, is not subject to review by the Office of Management and budget [sic] under the Paperwork Reduction Act of 1980 (44 U.S.C. 3507).

IV. Wage Index Tables

TABLE I-A.—WAGE INDEX FOR URBAN AREAS

SMSA area	Wage index
Abilene, TX	[6]0.8485
Akron, OH	[6]1.0417
Albany, GA	[6].8566
Albany-Schenectady-Troy, NY	.9624
Albuquerque, MN	[6]1.0009
Alexandria, LA	[5].9218
Allentown-Bethlehem-Easton, PA-NJ	[6]1.0569
Altoona, PA	1.0219
Amarillo, TX	.9233
Anaheim-Santa Ana-Garden Grove, CA	[6]1.2115
Anchorage, AK	[6]1.6461
Anderson, IN	[6].9812

* * *

[remainder of tables not reproduced]

Sec. 1102, 1814(b), 1861(v)(1), 1866(a), and 1871 of the Social Security Act (42 U.S.C. 1302, 1395f(b), 1395x(v)(1), 1395cc(a), 1395hh, and 42 CFR 405.460)

Dated: November 17, 1983

Carolyne K. Davis,

Administrator, Health Care Financing Administration.

Approved: February 8, 1984.

Margaret M. Heckler,

Secretary.

49 Fed. Reg. 46495-464501 (1984)

Health Care Financing Administration

(BERC-276-FN)

Medicare Program; Reissuance of the Wage Index in the 1981 Schedule of Limits on Hospital Per Diem Inpatient General Routine Operating Costs

AGENCY: Health Care Financing Administration (HCFA), HHS.

ACTION: Final notice.

SUMMARY: This notice affirms the use of the wage index that was used to calculate the 1981 schedule of limits on hospital per diem inpatient general routine operating costs, which was issued on June 30, 1981 (46 FR 33637), and September 30, 1981 (46 FR 48010). The 1981 wage index was reissued for public comment on February 17, 1984 (49 FR 6175).

EFFECTIVE DATE: This notice is effective December 26, 1984. It applies to cost reporting periods beginning on or after July 1, 1981, and cost reporting periods ending after September 30, 1981, as well as cost reporting periods beginning on or after October 1, 1981, and before October 1, 1982.

FOR FURTHER INFORMATION CONTACT:
Maureen McGrath, 301-594-7373.

SUPPLEMENTARY INFORMATION:

I. Background

In the **Federal Register** on February 17, 1984 (49 FR 6175), we described for public comment a change in the types of data that were used to calculate the wage index that was contained in the notices on the schedule of limits on hospital per diem inpatient general routine operating costs applicable to cost reporting periods beginning on or after July 1, 1981, and for cost reporting periods ending after September 30, 1981. As issued, the February 17, 1984, notice does not affect the cost limits for cost reporting periods beginning on or after October 1, 1982, because the limits for those cost reporting periods are governed by the notices published in the **Federal Register** on September 30, 1982 (47 FR 43296), and August 30, 1983 (48 FR 39426).

The proposed notice published February 17, 1984, reissued the wage index that was originally issued as part of the schedule of limits contained in notices published on June 30, 1981 (46 FR 33637), and September 30, 1981 (46 FR 48010). The latter notice contained adjustments to the limits required by section 2143 of the Omnibus Budget Reconciliation Act of 1981 (Pub. L. 97-35, enacted on August 13, 1981).

We reissued the 1981 wage index for public comment as the result of the April 29, 1983, decision of the United States District Court for the District of Columbia in the case of *District of Columbia Hospital Association, et al.* vs. *Heckler, et al.* (No. 82-2520 DDC). The District Court held that the 1981 schedule of hospital cost limits was invalid insofar as the schedule incorporated or was formulated by using a wage index that was calculated by excluding Federal Government hospital wage data. The court held that exclusion of Federal Government hospital wage data without having published the schedule for

public comment constituted a failure to comply with the Administrative Procedure Act (APA) (5 U.S.C. 553). The February 17, 1984, proposed notice was intended to remedy the rulemaking deficiencies perceived by the District Court and to validate use of the 1981 schedule of hospital cost limits by bringing the wage index contained in the 1981 schedule of limits into compliance with the APA.

II. Public Comments

In response to the February 17, 1984, proposed notice, we received comments from four hospital associations, an Indian health center, a major insurance company and a law firm representing a hospital association and its members. We received six comments favoring the exclusion of Federal hospital wage data in the calculation of the wage index. These commenters agreed that we should exclude Federal hospital wage data to improve the accuracy of the wage index. Two commenters favored the inclusion of Federal hospital wage data in the calculation of the wage index. A summary of these comments and our responses follow.

Comment—Two commenters suggested that we provide an appeals mechanism for those hospitals in areas where the exclusion of Federal hospitals from the wage index calculation produces a wage index factor that does not adequately reflect labor market forces.

Response—The rationale for excluding Federal hospital wage data from the wage index calculation is that Federal wages do not reflect the local labor market forces. If the Federal hospital wage data reflected the area's labor market, the index factor for an area would not be strongly affected by the exclusion of the Federal wage data.

A national system of cost limits presupposes that the same basic methodology will be applied to all hospitals. Therefore, in determining a wage index to be used by all

hospitals, the exclusion of Federal hospital wage data must be applied to all calculations of wage factors contained in the wage index. However, we believe it important to note that if an individual hospital in an area can demonstrate that its percentage of labor costs varies by more than ten percent from the percentage used to calculate the limits, an exception can be granted under our regulations in 42 CFR 405.460(f)(8).

In addition, it should be noted that under the existing appeals procedures, a hospital, in all instances, may protest any intermediary determination through administrative and judicial review proceedings.

Comment—One hospital association commented that the use of the Standard Metropolitan Statistical Area [SMSA/Non-SMSA] classification system does not reflect the hospital's local labor market.

Response—Since the inception of the cost limits in 1974, we have used SMSAs as the definition of urban areas because nationally accepted objective standards were needed. This method of classifying hospitals has been open for public comment since that time. The definition of SMSA was developed by the Executive Office of Management and Budget (EOMB) using population criteria and other standards such as the degree of economic and social integration among potientially [sic] qualifying counties. Currently, we know of no other nationally recognized classification system suitable for use in a national payment system. Also, we wish to note that the wage index is not intended to reflect the specific wages of one hospital but is intended to reflect general trends in the local economy.

Comment—Two commenters suggested that since including Federal hospital wage date changes the wage index factors only for a few areas, a notice of program reimbursement should be issued only when a hospital has successfully appealed its wage index.

Response—Including Federal hospital wage data would affect a large number of areas because the national

average wage would be increased by including Federal hospital wage data; however, areas without a Federal hospital will still have the same average wage. When the national average is divided by the area average, a lower index factor will result. It is our estimate that approximately 234 areas would receive lower wage index factors if Federal hospital wages were included in the wage index calculation.

Comment—One hospital association recommended that the methodology used for developing the wage index should continue to be studied.

Response—As part of our continuity efforts to refine the wage index methodology used under the prospective payment system for inpatient hospital services, we have asked each short term acute care Medicare participating hospital to complete a hospital wage survey. We hope to be able to use the information received from this survey to assess the effect of some of the technical deficiencies in the current wage index (for example, area differences in the use of part time employees) in order to determine how to develop an improved wage index methodology.

Comment—One commenter requested that we clarify whether the use of appropriate wage index values for some areas is due to a change in the Bureau of Labor Statistics (BLB) [sic] confidentiality requirements.

Response—The BLS supply us with data on wages and numbers of employees that are used to calculate the wage index. Because of BLS's confidentiality requirements, BLS could not disclose actual data for areas that included fewer than three reporting units. A reporting unit need not have been a single hospital. A reporting unit was (and is currently) defined by BLS as the smallest unit for which data are recorded on the employer's contribution report. For example, two facilities in the same area owned by one employer could have appeared as one reporting unit. Therefore, because of BLS's confidentiality requirements,

we used approximate rather than actual index values for 26 areas. These approximate values are identified by asterisks in table I-A.

Comments—One commenter believes that we should include Federal hospital wage data in the calculation of the wage index because of problems associated with averaging hospital wages in developing the wage index.

Response—The hospital wage index is designed to recognize relative differences in wage levels across the United States that reflect conditions present in local economies. The wage index is not intended to recognize the employment practices of any one institution. The reason for excluding Federal hospital wage data from the calculation of the wage index is not because of an averaging problem. We exclude Federal hospital wage data because the wages paid by a Federal hospital do not reflect the local economy since Federal wages are based primarily on national pay scales. If non-Federal hospitals are paying wages similar to Federal hospitals, this will be reflected in the area's reported quarterly hospital wages. However, if only one hospital in the area is paying high wages, the area's average will reflect this. It is possible that the hospital paying these higher costs is incurring unreasonable costs that are out of line with the costs of similar institutions. The cost limits have been established to prevent paying for costs that are unnecessary in the efficient delivery of health care services. It is our belief that wages that are out of line with similar institutions may be an indication that the hospital paying these higher wages is not being run as efficiently as other institutions in the area.

Comment—One hospital association suggested that we eliminate the lowest wage index factor in an area on a weighted average basis because Federal hospitals tend to be large and reflect a greater weight in the averaging process.

Response—By excluding Federal hospital wage data from the calculation of the wage index factors, we have

already eliminated the effect Federal hospital wages have on an area's average and on the national average.

Comment—One commenter recommended that we use a facility-specific wage index.

Response—The cost limits are based on a national system of classifying hospitals in bed size groupings and the limits are set at a percent of the mean labor-related costs and means nonlabor costs of each peer comparison group. The cost limits are used as a measure of a hospital's reasonable costs. Establishing a facility-specific index recogizes that all the wages paid at a hospital are part of its reasonable costs. A hospital may be paying wages that are unreasonable when compared to wages paid by similar providers. Recognizing these unreasonable costs as reasonable would be a violation of our responsibility to pay only those costs necessary for the efficient delivery of health care services.

Comment—One hospital association was of the opinion that eliminating Federal hospital wage data from the calculation of the wage index will lower reimbursement to facilities located around the Federal hospital.

Response—The elimination of Federal hospital wage data from the calculation of the wage index does not automatically result in lower reimbursement amounts to facilities around the Federal hospital. If a hospital's costs are under the limit, then the hospital will be reimbursed in full for its costs. We believe that the elimination of Federal hospital wage data from the calculation of the wage index gives hospitals a financial incentive to control costs within the allowed limit amount. It is our belief that the cost limits, as currently determined, more accurately reflect a hospital's reasonable costs than the use of cost limits that are artificially inflated by the use of a wage index factor that overstates the wages actually paid by hospitals in cer-

tain locales. Of course, as indicated above, if hospitals located in the same area as a Federal hospital are paying wages similar to those paid by the Federal hospital, then the index will reflect this.

Comment—A law firm representing a hospital association and its members commented that the proposed notice of February 17, 1984, is invalid under the APA because it is retroactive rulemaking.

Response—We do not consider this notice to be retroactive in nature, since as a practical matter hospitals could only have relied on the notice published on June 30, 1981, and September 30, 1981, in determining their respective cost limits for cost reporting periods beginning on or after July 1, 1982, and for cost reporting periods ending after September 30, 1981, and beginning on or after October 1, 1981. Moreover, there is substantial legal authority which permit's [sic] an agency a rule which covers an earlier period of time when it is reasonable to do so. The United States District Court for the District of Columbia did not rule that excluding Federal hospitals was an invalid methodology, but rather that we had not solicited public comments prior to making a change in methodology. At the time of the hearing, the plaintiffs in the case requested an order from the court to prevent the Secretary from republishing a wage index that excluded Federal hospital wage data. The court declined to do this. Therefore, we do not believe the ruling from the court precludes us from reissuing a wage index that excludes Federal hospital wage data. By issuing a proposed notice and final notice, we are correcting the procedural defect of not soliciting public comments before making a change in methodology. At the same time, we are not causing undue hardship to any hospital because there were no other published limits available for a hospital to use at the time of the original publication of the June 30 and September 30, 1981, notices. Each hospital knew in advance of its cost reporting period what its cost limit would be for this period. Given these circumstances and the public interest in ensuring that only those costs necessary in the efficient delivery of services be reimbursed, we believe this notice is valid.

Comment—One commenter recommended that the wage index published in the proposed notice be used for hospitals unless a hospital specifically requests a computation of its routine cost limit using a wage index that include Federal hospital wage data.

Response—The system of cost limits is to be uniformly applied to all hospitals. The use of a wage index excluding Federal hospital data for one group of hospitals and a wage index including Federal hospital data for another group would result in a two-tiered system. The use of a two-tiered system would be contrary to the principle of uniformity. In addition, it is our belief that those hospitals that would request a recomputation of the wage index to include Federal hospital wage data would be those hospitals that have exceeded the cost limits for the particular cost reporting period. As previously discussed, the cost limits are used to establish the reasonable and necessary costs for delivering efficient health care services. Recomputing the limits for those hospitals that exceeded the limits would violate the statutory requirement that we pay only those costs that are reasonable and necessary for the efficient delivery of needed health care services.

Even though only a limited number of hospitals are adversely affected by the exclusion of Federal hospital wage data, a significant amount of Medicare reimbursement is involved for each individual hospital that is affected. Since it is our belief that Federal hospital wage data do not reflect the conditions of local economies, allowing a recomputation of the wage index including Federal hospital wage data for those hospitals requesting it would result in our allowing these hospitals additional

reimbursement for costs that were not necessary in the efficient delivery of needed health care services. It would not be equitable to those hospitals that operated efficiently under the limits, for us to reward hospitals that exceeded the cost limits because they operated inefficiently.

Comment—One commenter stated that the change in the wage index does not permit hospitals sufficient time to adjust to the methodology change.

Response—We consider the change that was made to the wage index a minor technical change. It is our belief that hospitals were put on notice of this change on June 30, 1981 (46 FR 33637), when we first published the schedule of limits applicable to the affected period. The cost limits are effective at the beginning of a hospital's cost reporting period. Thus, a hospital has twelve months in which to adjust its routine inpatient operating costs to the published limits in order to receive full reimbursement for its Medicare costs. Since there were no other published limits for the affected period, the only notice a hospital could have relied on in determining its limit was the June 30, 1981, notice.

By republishing the same wage index at this time, we are correcting the procedural defect perceived by the court; that is, the failure to provide for a comment period.

Comment—One commenter noted that in a comparison of BLS data using only Federal hospital wage data for five SMSAs, there were variations in the average monthly wages reported to BLS for the Federal hospitals in each SMSA. For example, the data indicated high monthly wages in the San Francisco-Oakland, CA SMSA and low monthly wages in the Norfolk-Virginia Beach-Portsmouth, VA-NC SMSA. From this comparison, the commenter concludes that Federal hospitals do not necessarily use national wage scales.

Response—The difference in the monthly wages reported for the Federal hospitals in the SMSAs noted is not necessarily due to Federal hospitals paying local wages. We have always acknowledged that there are some technical deficiencies in the wage index that make it a less than perfect source for a wage index adjuster. For example, the data do not account for variations in hospital occupational mix, differences in the proportion of part-time employees, variations in overtime utilization, length of the work week, and differences in reporting compliance. Any one of these reasons could account for the discrepancy in average monthly wages.

We obtained the average monthly wages for the same five SMSAs but excluded Federal hospital wage data. In all five SMSAs the average monthly wages excluding Federal hospital wage data were lower than the average monthly wages for the Federal hospitals. In the Norfolk-Virginia Beach-Portsmouth, VA-NC SMSA the average monthly wage for Federal hospitals was $1,175.48 versus an average monthly wage of $865.77 not including any Federal hospitals. In the San Francisco-Oakland, CA SMSA, the average monthly wage for Federal hospitals was $1,564.75 versus an average monthly wage of $1,151.75 not including any Federal hospitals. Our comparison appears to prove our theory that Federal hospitals are not paying local wages. If the Federal hospitals were paying local wages, the average monthly wage for Federal hospitals would be the same figure as the average monthly wage not including Federal hospitals for the same SMSA.

Comment—A law firm commented that HCFA does not differentiate between urban and suburban locations within an SMSA. The commenter believes that a differentiation between urban and suburban would improve the accuracy of the wage index.

Response—In principle, using a wage index that differentiates urban (that is, "core") from suburban (that is, "ring") counties could provide a more precise wage index. However, it is our belief that the adoption of such a measure at this time is not feasible due to certain limitations of the BLS data used to construct the wage index. Although BLS data are the best data currently available that were compatible with a national payment system, it is important to note that, as previously explained, the data do contain certain technical deficiences. The BLS data do not account for differences in the proportion of part-time employees, area difference in occupational mix, variations in overtime utilization, length of the work week, and differences in reporting compliance. The current use of aggregated BLS data from all non-Federal hospitals within a specified SMSA mitigate the effect of these uncontrolled variables, particularly in large metropolitan areas with many hospitals. It is our belief that disaggregating the data into "core-ring" indexes would only magnify the inherent limitations of the BLS data and increase the potential for distortion, particularly in areas with few hospitals. The use of a "core-ring" urban wage index merits further study. However, pending the development of a data base which overcomes the techical limitations of the BLS data, we believe further wage index refinements must be deferred.

We would like to emphasize that a provider's location in an SMSA or non-SMSA has been used as a classification criterion for cost limit purposes continuously since 1974. The definitions of SMSA and New England County Metropolitan Area (NECMA) were developed by EOMB. Effective June 30, 1983, the definition of SMSA was replaced by Metropolitan Statistical Area (MSA). We do not independently determine when an area qualifies as an MSA. Rather, this determination is made by EOMB.

We believe this classification system is the only one currently available that meets the requirements of a national payment program. The SMSA (now MSA) classification is a widely accepted statistical standard developed for use by Federal agencies in the production, analysis, and publication of data on metropolitan areas. The standards were developed with the aim of producing definitions that are as consistent as possible for all SMSAs nationwide.

Comment—One Indian Health Service area representative recommended that HCFA use the general wage index for the area in which the Federal hospital is located to reimburse the Federal hospital. The commenter noted that most Indian Health Service hospitals are located in rural areas. The commenter pointed out that Indian Health Service hospitals are paid under the prospective payment system for inpatient hospital services using a wage index that is approximately 63 percent higher than the national average wage data.

Response—As stated previously, we believe Federal hospital wage data do not reflect the conditions within a local economy. Since Indian Health Service hospitals do not serve the general population of an area, and exist as a unique health care delivery system, they were included under the prospective payment system for inpatient hospital services using a single index value applicable to all Indian Health Service hospitals and specifically computed to be representative of the wage experience in the Indian Health Service system.

We wish to point out that the prospective payment system for inpatient hospital services is inherently different from the Medicare cost limits applicable in prior years in that the prospective rate determines the actual Medicare payment. Under the prior cost limit system payment was based on the costs incurred up to a maximum amount allowed by the cost limit. Because we considered it important that Indian Health Service hospitals have the

opportunity to participate in the prospective payment system for inpatient hospital services, and since they operate under a central administration, we established a single uniform wage index value for the Indian Health Service. Although the comment we received is in fact directed at an aspect of the prospective payment system for inpatient hospital services rather than the wage index issued for comment, we note that the essence of the commenter's statement is that wages in Indian Health Service hospitals will generally exceed those in the surrounding areas. We believe this comment from the Indian Health Service adds weight to our conclusion that wage levels in Federal hospitals are not usually representative of local wage conditions.

III. Changes in Reponse to Public Comments

We have decided not to recalculate the 1981 wage index to include data from Federal Government hospitals. Therefore, this notice affirms the exclusion of Federal Government hospital data from the wage index. It is our belief that the exclusion of Federal hospital data improves the accuracy of the wage index so that the index correctly reflects actual differences in wages from one area to another area. The wage index serves to reflect area-by-area differences in the labor related component of hospital costs. The more accurate the wage index, the more accurately it reflects these area-by-area differences and thus, ultimately, the more accurate are the cost limits. We conclude that the exclusion of Federal Government hospital data improves the accuracy of the wage index because most Federal hospitals characteristically employ physicians and other high salaried professionals whose salaries are based on national rather than local wage scales. This factor tends to overstate the average hospital wage in areas

with Federal institutions as compared to areas without such Federal facilities. Since the purpose of the wage index is to reflect area-by-area differences in the labor-related component of hospital costs, the exclusion of Federal hospital data better enables the wage index to reflect accurately area-by-area labor related costs.

In summary, we believe that the exclusion of Federal hospital data from the wage index reflects actual hospital experience. We wish to note that the data used to develop the wage index were supplied by BLS and are the most reliable data available. All hospitals are required under State unemployment compensation laws to report these data. However, if we discover that we or BLS have made an error based on data received from hospitals that result in an incorrect wage index for any area, we will publish corrected indexes and will direct the Medicare intermediaries to recalculate the limits for affected hospitals. However, BLS has advised us that it is unable to correct any inaccuracies in the wage index that may result from a hospital's failure to report the required wage data.

It should be noted that from the time the original schedule of limits was published in the June 30, 1981, notice BLS has advised us of various reporting errors in the wage and employment data. In addition, as noted earlier, on June 19, 1981, EOMB announced the designation of new MSAs and NECMAs, as well as other revisions in metropolitan classifications based on the results of the 1980 census. We have issued instructions to the intermediaries advising them of these changes. However, in those situations where the corrected data resulted in a lower wage index for an area, we continued to use the higher wage index. The wage indexes that are shown in Tables I-A and I-B reflect the corrections that have been made since June 30, 1981.

IV. Regulatory Impact Statement

A. Executive Order 12291 and Regulatory Flexibility Act

Executive Order 12291 requires us to prepare and publish a regulatory impact analysis for rules that are likely to have an annual effect on the economy of $100 million or more, cause a major increase in costs or prices, or meet other threshold criteria that are specified in that order. In addition, the Regulatory Flexibility Act (5 U.S.C. 601-612) requires us to prepare and publish a regulatory flexibility analysis for certain rules unless the Secretary certifies that the rules will not have a significant economic impact on a substantial number of small entities. (For purposes of the Regulatory Flexibility Act, we consider all hospitals to be small entities.) Under both the Executive Order and the Regulatory Flexibility Act, such analyses must, when prepared, show that the agency issuing the rules has examined alternatives that might minimize burden or otherwise ensure the rules to be cost-effective.

We have determined that this notice does not meet the criteria of either E.O. 12291 or the Regulatory Flexibility Act. We considered two alternatives:

- To republish an area wage index with values calculated as published in 1981 with no change in methodology; or
- To publish an area wage index with values recalculated to incorporate Federal hospitals in the base data.

We found that if we included Federal hospitals in the area wage index determinations, we would have to recalculate both urban and rural national average hospital wage levels, as well as the means used to determine the per diem limits for each group (published as Tables I and II in

the 1981 notices). This would affect the limit for every hospital subject to the limits, although only to a relatively small degree. The limits for some groups would increase, while the limits for other groups would decrease.

We determined that if we were to publish recalculated index values the net effect on overall program expenditures would be relatively small, due to the tendency of increases and decreases in group limits and index values to cancel each other out in the aggregate. A change of the area wage index to incorporate Federal hospitals in the base data would have the primary effect of redistributing marginal advantages and disadvantages. For each particular hospital, the effect of including Federal hospitals in the index data would be the result of multiplying the hospital's recalculated per diem limit for the hospital's group by the hospital's recalculated area wage index value. If both the group mean used to derive the limit applicable to a particular hospital, and the index value for that hospital were to increase or decrease, the effect of the recalculations would of course be compounded. If the change in the limit and the index were in opposite directions, however, they would tend to cancel each other out.

Including Federal hospital wage data would benefit only those few hospitals located in areas with Federal hospital employees, which would have higher index values as a result, and generally would disadvantage all those hospitals not located in such areas. Many Medicare participating hospitals could be adversely affected, since about 234 areas would have lower wage index values. However, the impact on the majority of individual hospitals would be relatively small.

In the aggregate, the reissuance of an area wage index excluding Federal hospitals will—

- Generally affect the annual Medicare revenues of individual hospitals by small amounts, compared to their total revenues;

• Have little net effect on aggregate hospital revenue from Medicare;
• Be more cost beneficial to hospitals as a whole;
• Have little or no effect on costs or prices; and
• Result in a smaller net disadvantage to hospitals as a whole.

In conclusion, the use of the wage index methodology as initially published in 1981 does not meet any of the criteria for identifying a major rule under E.O. 12291, and we have determined that this notice is a not a major rule and that a regulatory impact analysis is not required. In addition, the Secretary certifies under section 5 U.S.C. 605(b) of the Regulatory Flexibility Act, that this notice will not result in a significant economic impact on a substantial number of small entities, and that a regulatory flexibility analysis is not required.

B. Paperwork Burden

This notice contains no information collection requirements and, therefore, is not subject to review by EOMB under the Paperwork Reduction Act of 1980 (44 U.S.C. 3507).

VI. Wage Index Tables

TABLE I-A.—WAGE INDEX FOR URBAN AREAS

SMSA area	Wage index
Abilene, TX	0.8485
Akron, OH	1.0417
Albany, GA	.8566
Albany-Schenectady-Troy, NY	.9624
Albuquerque, NM	1.0009
Alexandria, LA	[5].9218
Allentown-Bethlehem-Easton, PA-NJ	1.0569
Altoona, PA	1.0219
Amarillo, TX	.9233
Anaheim-Santa Ana-Garden Grove, CA	1.2115
Anchorage, AK	1.6461
Anderson, IN	.9812

* * *

[remainder of tables not reproduced]

(Secs. 1102, 1814(b), 1861(v)(1), 1866(a), and 1871 of the Social Security Act (42 U.S.C. 1302, 1395f(b), 1395x(v)(1), 1395cc(a), 1395hh; and 42 CFR 405.460)

* * *

Dated: September 21, 1984

Carolyne K. Davis,

Administrator, Health Care Financing Administration.

Approved: October 30, 1984.

Margaret M. Heckler,

Secretary.

Medicare
Group Hospitalization, Inc. serves as Intermediary for Medicare Part A in the Washington, D.C. metropolitan area

Blue Cross
Group Hospitalization, Inc.
550 12th Street, S.W.
Washington, D.C. 20024
202/479-8000

March 12, 1985

Mr. Charles O'Brien
Administrator
Georgetown University Hospital
3800 Reservoir Road, N.W.
Washington, D.C. 20007

RE: Notice to Reopen and Correct Medicare Cost Report for the Fiscal Year Ended June 30, 1982

Dear Mr. O'Brien:

In accordance with Medicare Regulation No. 5—Subpart R, Sections 405.1885 and 405.1887, notice is hereby given that the above referenced cost report is to be reopened. Your routine cost limit report on Schedule D-1 has been revised to exclude federal hospital wages in its wage index. This is based on a reversal of the original United States District Court decision in Case No. 82-2526 (District of Columbia Hospital Association vs. Heckler) in which the court ruled that federal hospital wages should be included in the wage index. Notice of this change is published in the November 26, 1984 Federal Register Vol. 49, No. 228 and is effective December 26, 1984.

As a result of this decision, your routine cost limit has decreased from $171.96 to $167.24, resulting in an overpayment of $218,074 in cost reimbursement. A revised

Notice of Program Reimbursement will be issued in the near future requesting repayment of this amount.

If you are dissatisfied with the adjustments made as a result of this reopening and wish to appeal, any request for an appeal must be made in writing within 180 days from the date of the corrected final notice of program reimbursement in accordance with Regulation 405.1811 and/or 405.1841. For your information, the original notice of program reimbursement was dated June 29, 1984.

Please let me know if you have any questions concerning this notice.

Sincerely,

/s/ R. M. HUGNEY

R. M. Hugney
Staff Assistant
Provider Reimbursement

Medicare
Group Hospitalization, Inc. serves as Intermediary for Medicare Part A in the Washington, D.C. metropolitan area

Blue Cross
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As a result of this decision, your routine cost limit has decreased from $187.08 to $181.93, resulting in an overpayment of $223,881 in cost reimbursement. A revised Notice of Program Reimbursement will be issued in the near future requesting repayment of this amount.

If you are dissatisfied with the adjustments made as a result of this reopening and wish to appeal, any request for an appeal must be made in writing within 180 days from the date of the corrected final notice of program reimbursement in accordance with Regulation 405.1811 and/or 405.1841. For your information, the original notice of program reimbursement was dated June 27, 1984.

Please let me know if you have any questions concerning this notice.

Sincerely,

/s/ R. M. HUGNEY
R. M. Hugney
Staff Assistant
Provider Reimbursement

**H.R. Rep. No. 92-231, 92d Cong.,
1st Sess. 82-85 (1971) (excerpts)**

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[82] (*c*) *Limitations on coverage of costs under medicare.* – Your committee is mindful of the fact that costs can and do vary from one institution to another as a result of differences in size, in the nature and scope of services provided, the type of patient treated, the location of the institution and various other factors affecting the efficient delivery of needed health services. Your committee is also aware, however, that costs can vary from one institution to another as a result of variations in efficiency of operation, or the provision of amenities in plush surroundings. Your committee believes that it is undesirable from the standpoint of those who support Government mechanisms for financing health care to reimburse health care institutions for costs that flow from marked inefficiency in operation or conditions of excessive service.

[83] To the extent that differences in provider costs can be expected to result from such factors as the size of the institution, patient mix, scope of services offered or other economic factors, wide, but not unlimited recognition should be given to the variations in costs accepted as reasonable. However, data frequently reveals wide variations in costs among institutions that can only be attributable to those elements of costs that would ordinarily not be expected to vary substantially from one institution to another.

Where the high costs do in fact flow from the provision of services in excess of or more expensive than generally considered necessary to the efficient provision of appropriate patient care, patients may nevertheless desire such services. It is not the committee's view that if patients

desire unusually expensive service they should be denied the service. However, it is unreasonable for medicare or medicaid (which are financed by almost all people in the country rather than the patient or community that wants the expensive services) to pay for it.

Similarly when the high costs flow from inefficency in the delivery of needed health care services the institution should not be shielded from the economic consequences of its inefficiency. Health care institutions, like other entities in our economy should be encouraged to perform efficiently and when they fail to do so should expect to suffer the financial consequences. Unfortunately a reimbursement mechanism that responds to whatever costs a particular institution incurs presents obstacles to the achievement of these objectives. It is believed that they can only be accomplished by reimbursement mechanisms that limit reimbursement to the costs that would be incurred by a reasonably prudent and cost-conscious management.

Present law provides authority to disallow incurred costs that are not reasonable. However, there are a number of problems that inhibit effective exercise of this authority. The disallowance of costs that are substantially out of line with those of comparable providers after such costs have been incurred creates financial uncertainty for the provider, since, as the system now operates, the provider has no way of knowing until sometime after it incurs expenses whether or not they will be in line with expenses incurred by comparable providers in the same period. Furthermore, present law generally limits exercise of the authority to disallow costs to instances that can be specifically proved on a case-by-case basis. Clear demonstration of the specific reason that a cost is high is generally very difficult. And, since a provider cannot charge a beneficiary more than the program's deductible and coinsurance amounts for covered services, exercise of

either type of authority can leave the provider without reimbursement for some costs of items or services it has already incurred for patients treated some time ago. Under these circumstances the provider would have to obtain funds from some other source to make up for its deficit.

The proposed new authority to set limits on costs recognized for certain classes of providers in various service areas differs from existing authority in several ways and meets these problems. First, it would be exercised on a prospective, rather than retrospective, basis so that the provider would know in advance the limits to Government recognition of incurred costs and have the opportunity to act to avoid having costs that are not reimbursable. Second, the evaluation of the costs necessary in delivering covered services to beneficiaries would be exercised on a class and a presumptive basis—relatively high costs [84] that cannot be justified by the provider as reasonable for the results obtained would not be reimbursable—so that implementation of the proposed authority would appear more feasible than present authority. Third, since the limits would be defined in advance, provision would be made for a provider to charge the beneficiary for the costs of items or services in excess of or more expensive than those that are determined to be necessary in the efficient delivery of needed health services. Public notice would be provided where such charges are imposed by the institution and the beneficiary would be specifically advised of the nature and amount of such charges prior to admission so that there is opportunity for the public, doctors, and their medicare patients to know what additional payment would have to be made. Your committee expects that the provision will not be applicable where there is only one hospital in a community—that is, where, if the provision were applied, additional charges could be imposed on beneficiaries who have no real opportunity to use a less

expensive, non-luxury institution, and where the provision would be difficult to apply because comparative cost data for the area are lacking.

Your committee recognizes that the initial ceilings imposed will of necessity be imprecise in defining the actual cost of efficiently delivering needed health care. And your committee recognizes that these provisions will apply to a relatively quite small number of institutions. The data that are available for this purpose will often be less than perfectly reliable—for example, it may be necessary to use unaudited cost reports or survey or sampling techniques in estimating the costs necessary to the efficient delivery of care. Under medicare's administrative system, however, cost reports prepared by the providers are now being submitted more promptly after the close of the accounting period and should be available for analysis in the next year and for the establishment of limits in the second following year. Also, the precision of the limits determined from these data will vary with the degree to which excessive costs can be distinguished from the provision of higher quality or intensity of care.

For costs that would not generally be expected to vary with essential quality ingredients and intensity of medical care—for example, the costs of the "hotel" services (food and room costs) provided by hospitals—the Secretary might set limits sufficiently above the average costs per patient day previously experienced by a class of hospitals to make allowance for differing circumstances and short-term economic fluctuations. Hotel services may be easiest to establish limits for and be among the first for which work can be completed. Attention might be given as well to laundry costs, medical record costs, and administration costs within the reasonably near future.

Setting limits on overall costs per patient day and specific costs that vary with the quality and intensity of

care would be more difficult, but the Secretary might be able to set reasonable limits sufficiently above average costs per patient day previously experienced by a class of institutions so that only cases with extraordinary expenses would be subject to any limits. In addition, special limits could be established on cost elements found subject to abuse. For example, the Secretary might establish limits on the level of standby costs that would be recognized as reasonable under the program to prevent Government programs from picking up the cost of excessive amounts of idle capacity—particularly relatively high personnel costs in relation [85] to patient loads where occupancy rates are low—in reimbursing for services to covered patients.

Providers would, of course, have the right to obtain reconsideration of their classification for purposes of cost limits applied to them and to obtain relief from the effect of the cost limits on the basis of evidence of the need for such an exception.

Providers will be permitted to collect costs in excess of the medicare ceilings from the beneficiary (except in the case of admission by a physician who has a direct or indirect financial interest in a facility) where these costs flow from items or services in excess of or more expensive than those necessary for the effective delivery of needed services, provided all patients are so charged and the beneficiary is informed of his liability in advance. Information on additional charges assessed would also be made available generally in the community. Your committee is also requesting that the Secretary submit annually to it a report identifying the providers that make such additional charges to beneficiaries and furnishing information on the amounts being charged by such providers.

The determination of the cost of the excess items or services for which the beneficiary may be charged will be

made on the basis of costs previously experienced by the provider. For example, if costs for food services experienced in 1969 among a group of hospitals in an area ranged from $4 to $9 a day with a median cost of $5 a day and the limit for food services set by the Secretary for 1971 was $7.20 a day, the hospital previously experiencing costs of $9 a day could charge patients $1.80 a day for food services. However, should total reimbursement for covered services from the program plus charges billed for such services exceed actual costs in any year, the excess will be deducted from payments to the provider. Thus, the provider would not profit from charges to beneficiaries based on excess costs in the prior year.

In addition it should be noted that the fact that a provider's costs are below the ceilings established under this provision will not exempt it from application of the ceiling of customary charges where such charges are less than cost under another provision in the committee bill.

The provision would be effective with respect to accounting periods beginning after June 30, 1972.

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S. Rep. No. 91-1230, 92d Cong.,
2d Sess. 187-190 (1972) (excerpts)

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[187] **Limitations on Coverage of Costs Under Medicare**
(Sec. 223 of the bill)

The committee is mindful of the fact that costs can and do vary from one institution to another as a result of differences in size, in the nature and scope of services provided, the type of patient treated, the location of the institution and various other factors affecting the efficient delivery of needed health services. The committee is also aware, however, that costs can vary from one institution to another as a result of variations in efficiency of operation, or the provision of amenities in plush surroundings. The committee believes that it is undesirable from the standpoint of those who support Government mechanisms for financing health care to reimburse health care institutions for costs that flow from marked inefficiency in operation or conditions of excessive service.

To the extent that differences in provider costs can be expected to result from such factors as the size of the institution, patient mix, scope of services offered or other economic factors, wide, but not unlimited recognition should be given to the variations in costs accepted as reasonable. However, data frequently reveals wide variations in costs among institutions that can only be attributable to those elements of cost that would ordinarily not be expected to vary substantially from one institution to another.

Whether the high costs do in fact flow from the provision of services substantially in excess of or more expensive than generally considered necessary to the efficient provision of appropriate patient care, patients may nevertheless desire such services. It is not intended that patients

who desire unusually expensive service should be denied the service. However, it is unreasonable for medicare or medicaid (which are financed by almost all people in the country rather than the patient or community that wants the expensive services) to pay for it.

Similarly when the high costs flow from inefficiency in the delivery of needed health care services the institution should not be shielded from the economic consequences of its inefficiency. Health care institutions, like other entities in our economy should be encouraged to perform efficiently and when they fail to do so should expect to suffer the financial consequences. Unfortunately a reimbursement mechanism that responds to whatever costs a particular institution incurs presents obstacles to the achievement of these objectives. The committee believes that the objectives can only be accomplished by reimbursement mechanisms that limit reimbursement to the costs that would be incurred by a reasonably prudent and cost-conscious management.

[188] Present law provides authority to disallow incurred costs that are not reasonable. However, there are a number of problems that inhibit effective exercise of this authority. The disallowance of costs that are substantially out of line with those of comparable providers after such costs have been incurred creates financial uncertainty for the provider, since, as the system now operates, the provider has no way of knowing until sometime after it incurs expenses whether or not they will be in line with expenses incurred by comparable providers in the same period. Furthermore, present law generally limits exercise of the authority to disallow costs to instances that can be specifically proved on a case-by-case basis. Clear demonstration of the specific reason that a cost is high is generally very difficult. And, since a provider cannot charge a beneficiary more than the program's deductible

and coinsurance amounts for covered services, exercise of either type of authority can leave the provider without reimbursement for some costs of items or services it has already incurred for patients treated some time ago. Under these circumstances the provider would have to obtain funds from some other source to make up for its deficit.

Accordingly, the committee has approved a provision in the House bill which would authorize the Secretary of Health, Education, and Welfare to set limits on costs recognized as reasonable for certain classes of providers in various service areas. This authority differs from existing authority in several ways and meets these problems. First, it would be exercised on a prospective, rather than retrospective, basis so that the provider would know in advance the limits to Government recognition of incurred costs and have the opportunity to act to avoid having costs that are not reimbursable. Second, the evaluation of the costs necessary in delivering covered services to beneficiaries would be exercised on a class and a presumptive basis—relatively high costs that cannot be justified by the provider as reasonable for the result obtained would not be reimbursable—so that implementation of the proposed authority would appear more feasible than present authority. Third, since the limits would be defined in advance except with respect to emergency care, provision would be made for a provider to charge the beneficiary for the costs of items or services substantially in excess of or more expensive than those that are determined to be necessary in the efficient delivery of needed health services. Public notice would be provided where such charges are imposed by the institution and the beneficiary would be specifically advised of the nature and the amount of such charges prior to admission so that there is opportunity for the public, doctors, and their medicare patients to know what additional payment would have to be made.

The committee expects that the provision will not be applicable where there is only one hospital in a community—that is, where, if the provision were applied, additional charges could be imposed on beneficiaries who have no real opportunity to use a less expensive, nonluxury institution, and where the provision would be difficult to apply because comparative cost data for the area are lacking.

The committee, along with the Committee on Ways and Means, recognizes that the initial ceilings imposed will of necessity be imprecise in defining the actual cost of efficiently delivering needed health care. And the committee recognizes that these provisions [189] will apply to a relatively quite small number of institutions. The data that are available for this purpose will often be less than perfectly reliable—for example, it may be necessary to use unaudited cost reports or survey or sampling techniques in estimating the costs necessary to the efficient delivery of care. Under medicare's administrative system, however, cost reports prepared by the providers are now being submitted more promptly after the close of the accounting period and should be available for analysis in the next year and for the establishment of limits in the second following year. Also, the precision of the limits determined from these data will vary with the degree to which excessive costs can be distinguished from the provision of higher quality or intensity of care.

For costs that would not generally be expected to vary with essential quality ingredients and intensity of medical care—for example, the costs of the "hotel" services (food and room costs) provided by hospitals—the Secretary might set limits sufficiently above the average costs per patient day previously experienced by a class of hospitals to make allowance for differing circumstances and short-term economic fluctuations. Hotel services may be easiest

to establish limits for and be among the first for which work can be completed. Attention might be given as well to laundry costs, medical record costs, and administration costs within the reasonably near future.

Setting limits on overall costs per patient day and specific costs that vary with the quality and intensity of care would be more difficult, but the Secretary might be able to set reasonable limits sufficiently above average costs per patient day previously experienced by a class of institutions so that only cases with extraordinary expenses would be subject to any limits. In addition, special limits could be established on cost elements found subject to abuse. For example, the Secretary might establish limits on the level of standby costs that would be recognized as reasonable under the program to prevent Government programs from picking up the cost of excessive amounts of idle capacity—particularly relatively high personnel costs in relation to patient loads where occupancy rates are low—in reimbursing for services to covered patients.

Providers would, of course, have the right to obtain reconsideration of their classification for purposes of cost limits applied to them and to obtain relief from the effect of the cost limits on the basis of evidence of the need for such an exception.

For other than emergency care, providers will be permitted to collect costs in excess of the medicare ceilings from the beneficiary (except in the case of admission by a physician who has a direct or indirect financial interest in a facility) where these costs flow from items or services substantially in excess of or more expensive than those necessary for the effective delivery of needed services, provided all patients are so charged and the beneficiary is informed of his liability in advance. Information on additional charges assessed would also be made available generally in the community. The committee is also requesting that the Secretary submit annually to it a report identifying the providers that make such additional charges to beneficiaries and furnishing information on the amounts being charged by such providers.

[190] The determination of the cost of the excess items or services for which the beneficiary may be charged will be made on the basis of cost previously experienced by the provider. For example, if costs for food services experienced in 1969 among a group of hospitals in an area ranged from $4 to $9 a day with a median cost of $5 a day and the limit for food services set by the Secretary for 1971 was $7.20 a day, the hospital previously experiencing costs of $9 a day could charge patients $1.80 a day for food services. However, should total reimbursement for covered services from the program plus charges billed for such services exceed actual costs in any year, the excess will be deducted from payments to the provider. Thus, the provider would not profit from charges to beneficiaries based on excess costs in the prior year.

In addition it should be noted that the fact that a provider's costs are below the ceilings established under this provision will not exempt it from application of the ceiling of customary charges where such charges are less than cost under another provision in the committee bill.

The provision would be effective with respect to accounting periods beginning after December 31, 1972.

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¶ 31,645 HFCA ADMINISTRATOR DECISION – LIMITATION ON REIMBURSABLE COSTS – ACCOUNTING FOR LABOR/DELIVERY ROOM DAYS

HFCA Deputy Administrator Decision, Nov. 7, 1981. *Beth Israel Hospital (Boston, Mass.) v. Blue Cross Assoc./Blue Cross/Blue Shield of Massachusetts.*

* * *

This case is before the Deputy Administrator, Health Care Financing Administration, for review of the decision entered by the Provider Reimbursement Review Board. The review is during the 60-day period in Section 1878(f)(1) of the Social Security Act, as amended [42 USC 1395oo(f)]. Comments were received from the Intermediary requesting reversal of the Board's decision as to Issue No. 3 and from the Bureau of Program Policy requesting affirmation of Issue No. 1 and reversal of Issue No. 2. The provider submitted comments requesting reversal of Issue No. 1 and affirmation of Issue Nos. 2 and 3. Accordingly, the case is now before the Deputy Administrator for final administrative decision.

The Issues

Issue No. 1 – Bed size category

The Board held that although the provider increased the number of its available beds to over 405 during its 1976 cost year, the number of beds available on the first day of the cost year determined the providers' classification for purposes of the routine cost limitation under 42 CFR 405.460 to be in the 100-404 bed size category for the entire cost reporting period ending September 25, 1976.

Issue No. 2 – Extraordinary Circumstance Exception

The Board held that the opening of a new addition to the provider's facility was an extraordinary circumstance beyond the provider's control and supported an exception to the routine cost limits under 42 CFR 405.460(f)(3) for the cost reporting period ending September 25, 1976.

* * *

Summary of Bureau of Program Policy's Comments

Issue No. 1, the Bureau of Program Policy commented through its Division of Health Care Cost Containment, had been decided properly by the Board in accordance with established policy. In response to a request for additional clarifying information on this issue, the Division commented that Medicare policy required the cost limits to be applied prospectively. This follows the congressional intent expressed in the Senate Finance Committee Report that accompanied § 223 of P.L. 92-603. The intent is for the provider to know in advance the limits and have the opportunity to avoid having unreimbursed costs.

Accordingly, 42 CFR 405.460(a) directed the limits to be imposed prospectively. § 2510.5 of the *Provider Reimbursement Manual* therefore, requires a provider's bedsize category to be determined on the first day of the cost reporting period.

As to *Issue No. 2*, the Division recommended reversal, because the provider did not satisfy the conditions set forth in *BCA Administrative Bulletin* No. 1185 for an extraordinary circumstance exception. Further, the Board's decision on this issue goes well beyond the intent of 42 CFR 405.460(f)(3) which is to protect providers from events unrelated to their own decisions.

* * *

Summary of Provider's Comments

Concerning *Issue No. 1*, the provider requested reversal of the Board's decision, noting that for almost two-thirds of its cost year, its bed size exceeded 404 beds. The Medicare statute does not mandate that cost limits be imposed prospectively, and a recent amendment to 42 CFR 405.460(a) eliminated the language that the cost limits be imposed prospectively. Further, 42 CFR 405.460(f) authorizes departures from prospectivity by making provisions for exceptions.

The prospective nature of the limits is not weakened by the reclassification of a provider experiencing a significant change in bed size during its cost year. The criteria for setting the limits and the limits themselves are established prior to the cost reporting period. The criteria and limits do not change. This is all that § 405.460(a) and prospectivity require. When a provider's circumstances change signficantly after the start of its cost year, a new limit should be computed, consistent with the applicable criteria, to be applied prospectively for the remainder of the year.

Concerning *Issue No. 2*, the provider urged affirmation of the Board's decision, writing that the purpose of the extraordinary circumstances exception is to relieve providers from the operation of the cost limits to the extent that unusual circumstances prevent them from avoiding excessive costs. The opening of the provider's new building was such an unusual event. "A retroactive corrective adjustment" is required to reimburse the provider its reasonable costs.

The provider questioned the Intermediary's reliance on *BCA Administrative Bulletin* No. 1185, which limits new

construction exceptions to loss of licensure situations. That bulletin is unsupported by law and regulations and was never promulgated pursuant to the *Administrative Procedure Act*. As there is no rational basis to distinguish construction costs incurred due to orderly renovation from those incurred due to a threatened loss of licensure, HCFA's policy is arbitrary and capricious.

* * *

Laws and Regulations

[The "Laws and Regulations" portion of the Administrator's decision has been omitted. It contained excerpts from the following: Regulation §§ 405.460(a) (¶ 7515), 405.460(e) (¶ 7515), 405.460(f)(l) (¶ 7515), 405.460(f)(3) (¶ 7515); *Provider Reimbursement Manual* (HIM-15) § 2345 (¶ 6894) and (HIM-15) § 2510.5 (¶7531E); and *BCA Administrative Bulletin* No. 1185.]

Discussion and Evaluation

All the evidence which was furnished by the Provider Reimbursement Review Board has been considered, including all position papers and exhibits submitted by the parties. The Board's decision, having been rendered, at the request of the parties, without an oral hearing, has been carefully reviewed. The comments received after the Board issued its decision have been considered. The statement of facts set forth by the Board is incorporated by reference.

Issue No. 1 – Bed size category

By enacting Sec. 223 of P.L. 92-603 [codified in 42 USC 1395x], Congress authorized the Secretary of Health and

Human Services to prescribe regulations establishing limits on the coverage of costs reimbursable by Medicare. Pursuant to this authorization, 42 CFR 405.460 was issued to limit Medicare reimbursement to those costs considered necessary in the efficient delivery of needed health services. One of the factors to be considered under this regulation is the size of the institution to which the cost limits apply. Size is measured by the number of available beds. Prior to the beginning of a cost period, the Secretary publishes a notice in the *Federal Register* specifying the dollar amount of the cost limit to be applied during that cost period for each of the various categories of providers.

This notice is published prior to the cost period to effectuate legislative intent. That intent was expressed in the Report of the Senate Committee on Finance which accompanied P.L. 92-603. This report stated: "First, [the cost limit] would be exercised on a prospective, rather than retrospective, basis so that the provider would know in advance the limits to Government recognition of incurred costs and have the opportunity to act to avoid having costs that are not reimbursable."

In furtherance of this Congressional intent, §2510.5 of the *Provider Reimbursement Manual* (HIM-15) was developed to require a provider's bed size category to be determined "as of the first day of the pertinent cost reporting period."

The intent of Congress on reclassification to the cost limits is shown in the Senate Finance Committee Report. "Providers would, of course, have the right to obtain reconsideration of their classification for purposes of cost limits applied to them and to obtain relief from the effect of the cost limits on the basis of evidence of the need for such an exception." (S. Rep. No. 1230, 92nd Cong., 2d Sess. 188 (1972)).

Under 42 CFR 405.460(e), the provider is entitled to request a review of its classification for purposes of applying the cost limits. 42 CFR 405.460(f)(1) permits a reclassification if the provider's classification is at variance with the criteria specified in the *Federal Register* notice establishing cost limits for each year. This regulation does not preclude a reclassification based on events occurring during the cost year.

The provider had 367 beds available on the first day of its cost reporting period ending September 25, 1976. Therefore, the provider was classified in the 100-404 bed size category. In this category, the provider was entitled to a routine per diem cost limit of $115.43. On February 16, 1976, the provider's bed size increased to over 404 beds, due to the opening of a new building. At that time, 223 days remained in the provider's 1976 cost reporting period. The provider's bed size increased from 367 beds to 412 beds, a net gain of 45 beds. The routine per diem cost limit in the 405-684 bed size category during the cost year at issue was $138.13.

Having exceeded the cost limit based on 367 beds, the provider sought a reclassification to the 405-684 bed size category. This reclassification was denied. The denial was based on § 2510.5 of HIM-15 and the general policy to apply cost limits prospectively.

It is the opinion of the Deputy Administrator that the literal application of § 2510.5 in a situation such as this is not required by law or Congressional intent. When an event occurs during the cost year that both changes a provider's eligibility for a new classification and significantly increases the provider's costs, a reclassification would not violate prospectivity. The criteria for setting the limits and the limits themselves would be established for all

categories prior to the cost reporting period. The criteria and the limits would not change during that period. This is all that prospectivity requires under the circumstances in this case.

The Deputy Administrator notes that the provider's increase in bed size was substantial: 45 beds, approximately a 12% increase, and that the increase existed over 61% of the cost year at issue. Such an increase for such a period can be expected to have significantly affected the provider's per diem costs. Accordingly, it is the Deputy Administrator's opinion that the provider is entitled to be classified in the 405-684 bed size category for the cost year at issue.

Issue No. 2—Extraordinary Circumstance Exception

Under 42 CFR 405.460(f), an exception to the cost limits may be granted upon the provider's demonstration that certain conditions are present. 42 CFR 405.460(f)(3) authorizes an exception when a provider experiences substantial increased costs attributable to extraordinary circumstances beyond a provider's control. Examples given in this regulation of unusual occurrences which may give rise to this exception are "strikes, fire, earthquake, [or] flood." The regulation recognizes that "similar unusual occurrences" also may constitute an extraordinary circumstance.

The provider has sought an exception under this regulation for the increased costs of depreciation, interest, nursing, housekeeping, and maintenance incurred as a result of opening a new, 8-story, inpatient addition to the hospital. This exception was sought as an alternative to Issue No. 1 as a basis for relief from the cost limits.

The provider contends that the opening of a major addition to the hospital was an extraordinary circumstance giving rise to an exception. It is the Deputy Administrator's opinion, however, that the provider's contentions are not persuasive, because a key requirement for this exception is that the extraordiary circumstance be beyond the control of the provider.

Such absence of control is clearly lacking in this case. The provider applied to the State of Massachusetts for a certificate of need to construct the addition. The provider obtained financing through a public bond issuance for the project. The provider established a timetable in conjunction with the architects and the construction company engaged by the provider to carry out the project. The exception under 42 CFR 405.460(f)(3) was not intended for a situation where the provider exercised this degree of control.

Further, the opening of the addition is not an event similar to the specific unusual occurrences listed in the regulation. Those specific occurrences establish a frame of reference against which other circumstances may be measured. The four listed occurrences are catastrophes or events otherwise detrimental to a provider. The provider's opening of its addition was clearly not a detrimental event.

The provider questioned, as without rational justification, the Program's denial of this exception in light of the policy to permit an exception when new construction is undertaken in response to a threatened loss of licensure or accreditation. The Deputy Administrator believes the two situations are clearly distinguishable. Threat of a loss of licensure or accreditation is often beyond the provider's control. To adopt the provider's contentions would effectively destroy the incentive to control costs relating to new

construction. Accordingly, the provider is not entitled to an extraordinary circumstance exception.

* * *

Findings of Fact

1. The amounts in controversy exceed $10,000 for each of the provider's cost reporting periods ending September 25, 1976; September 24, 1977; and September 30, 1978.

2. The provider is a non-profit, general, acute-care, teaching hospital affiliated with Harvard University.

Issue No. 1—Bed size category

3. On September 28, 1975, the first day of the provider's cost reporting period ending September 25, 1976, the provider had a bed complement of 367 beds (Stipulation of Facts (SF, p. 4)).

4. Between February 4 and February 26, 1976, the provider opened a new 176-bed inpatient addition to the hospital while closing 131 beds in the old building, for a net increase of 45 beds (SF, p. 4).

5. On February 16, 1976, when 233 days remained in the provider's 1976 cost reporting year, the provider's bed capacity for the first time exceeded 404 beds (SF, p. 4).

6. Throughout the provider's 1976 cost reporting year, the provider was a Group I hospital located in a Standard Metropolitan Statistical Area (SMSA) (SF, p. 7).

7. During the 1976 cost reporting year, SMSA Group I hospitals were classified into the following categories for cost limit purposes:

Less than 100
100 to 404
405 to 684
685 and above (SF, p. 7-8).

8. The hospital inpatient general routine service cost limit for a Group I SMSA hospital in the 100 to 404 bed size category, adjusted for a cost reporting period beginning October 1, 1975, was $115.43 per diem. In the 405 to 684 bed category, it was $138.31 (SF, p. 7-8).

9. The provider's audited routine service cost per diem for its FYE September 25, 1976, was $133.33 (SF, p. 9).

10. HCFA granted the provider adjustments to its routine cost limit for atypical intern and resident costs ($13.73 per diem) and extraordinary malpractice insurance costs ($1.71 per diem) (SF, p. 11).

Issue No. 2—Extraordinary Circumstance Exception

11. Findings No. 1 through 10 above are relevant to and incorporated as Findings also as to Issue No. 2.

12. In 1971, the provider applied to the Massachusetts Department of Public Health for, and received in 1972, a certificate of need to construct an $18,725,000 eight-story inpatient addition to the hospital to be known as the Feldberg Building (SF, p. 3 & 4).

13. In 1973, construction was started on the Feldberg Building under a timetable established by the provider that planned for occupancy of the building in January 1976 (SF, p. 3).

14. Construction followed the three-year timetable laid out by the provider, and occupancy began in February 1976 (SF, p. 13-14).

15. During the provider's 1976 cost year, the provider incurred additional inpatient routine service costs of $6.89 per diem attributable to operations in the new beds in the Feldberg Building (SF, p. 14).

16. The Feldberg Building was not constructed for the purpose of maintaining licensure, JCAH accreditation, or Medicare certification.

* * *

Conclusions of Law

Issue No. 1—Bed size category

1. The provider's claimed Medicare reimbursement for routine per diem costs is subject to limitation under Sec. 1861(v)(1)(A) of the Social Security Act, as amended [42 USC 1395x] and 42 CFR 405/460(a).

2. Having experienced a substantial increase in its bed-size for a significant portion of its 1976 cost year, the provider was entitled to a reclassification of its bed-size category for routine cost limit purposes under 42 CFR 405.460(f)(1).

Issue No. 2—Extraordinary Circumstances Exception

3. The provider's opening of a new 176-bed inpatient addition to the hospital during its 1976 cost year was not beyond the control of the provider within the meaning of 42 CFR 405.460(f)(3).

4. The opening of a new 176-bed inpatient building by the provider does not constitute an "extraordinary circumstance" under 42 CFR 405.460(f)(3).

5. The provider is not entitled to an exception to the routine cost limits due to the opening of its Feldberg Building under 42 CFR 405.460(f)(3).

6. The provider's opening of a new 176-bed inpatient addition to the hospital was not an unusual occurrence similar to a strike, fire, earthquake, or flood, under 42 CFR 405.460(f)(3).

* * *

Decision

Issue No. 1

The decision of the Provider Reimbursement Review Board is reversed. The provider is entitled to be classified in the 405-684 bed size category for its cost reporting period ending September 25, 1976.

Issue No. 2

The decision of the Provider Reimbursement Review Board is reversed. The provider is not entitled to an "extraordinary circumstance" exception to the routine cost limits for its cost reporting period ending September 25, 1976.

* * *

This Constitutes the Final Administrative Decision of the Secretary of Health and Human Services.

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43 Fed. Reg. 25873 (1978)

MEDICARE PROGRAM

Extension of Grace Period for Recently Reclassified Hospitals

AGENCY: Health Care Financing Administration (HCFA), HEW.

ACTION: Notice.

SUMMARY: This notice provides an additional 1-year grace period for all hospitals that received the grace period for reclassified hospitals for cost reporting periods beginning on or after July 1, 1977 but before July 1, 1978.

EFFECTIVE DATE: This notice will become effective July 1, 1978.

FOR FURTHER INFORMATION CONTACT:
Bill Goeller, 301-594-9820.

SUPPLEMENTARY INFORMATION: A schedule of Medicare limits is promulgated each year. For cost reporting periods beginning on or after July 1, 1976 (schedule published on June 30, 1976 at 41 FR 26992), we have allowed a 1-year grace period for hospitals that are reclassified into a lower group because of a relative decline in the per capita income of the hospital's area or a change in the area's SMSA/SCSA designation. By virtue of this grace period, a reclassified hospital is subject to the higher of (a) the current limit of the group in which it is currently classified or (b) the current limit of the group in which it was classified in the immediately preceding cost reporting year. The purpose of this grace period is to "lessen the effect of unusual short-term fluctuations in area per capita income and the impact of such fluctuations on reimbursement of individual providers." The 1-year grace period provision was retained in the schedule of limits for cost reporting periods

beginning on or after July 1, 1977 (published on July 8, 1977 at 42 FR 35495) and the schedule of limits for cost reporting periods beginning on or after October 1, 1977 (published on October 3, 1977 at 42 FR 53675).

We have received many comments suggesting that a 1-year grace period does not allow a hospital adequate time to adapt its operation to the limits of the lower group. We recognize that accommodation to a lower cost level may require adjustment of staff schedules and purchasing practices that is hard to accomplish quickly. Accordingly, pending further review of this matter, we have decided to, and hereby do, extend the grace period for an additional year for those hospitals that have received the grace period for cost reporting years beginning on or after July 1, 1977 but before July 1, 1978.

The following example illustrates the effect of this rule:

Example. Hospital A's cost reporting period begins on July 1. On July 1, 1976, it was classified in Group II. On July 1, 1977 and again on July 1, 1978, it was classified in Group III, for its cost reporting year beginning July 1, 1978, Hospital A will be subject to the higher of the current Group II or the current Group III limit.

We find good cause for dispensing with opportunity for public comment and for making this policy effective July 1, 1978. It is needed to assure that hospitals not experience unnecessary hardship from a recent reclassification. It does not prejudice any hospital but provides a benefit (which we believe to be in the public interest) for a substantial number of recently reclassified hospitals.

(Secs. 1102, 1861(v)(1), 1866(a), and 1871 of the Social Security Act: 49 Stat. 647; 79 Stat. 322; 79 Stat. 327; 79 Stat. 331; 86 Stat. 1393; 42 U.S.C. 1302, 1395x(v)(1), 1395cc(a) and 1395hh.)

(Catalog of Federal Domestic Assistance Program No. 13.773, Medicare – Hospital Insurance.)

Dated: May 26, 1978.

William D. Fullerton,
Acting Administrator, Health Care Financing Administration.

Approved: June 8, 1978.

JOSEPH A. CALIFANO, JR.,
Secretary.

[FR Doc. 78-16365 Filed 6-14-78; 8:45 am]

Supreme Court of the United States

No. 87-1097

OTIS R. BOWEN, SECRETARY OF HEALTH AND HUMAN SERVICES, PETITIONER

v.

GEORGETOWN UNIVERSITY HOSPITAL, ET AL.

ORDER ALLOWING CERTIORARI. Filed February 29, 1988

The petition herein for a writ of certiorari to the United States Court of Appeals for the District of Columbia Circuit is granted.

☆ U.S. GOVERNMENT PRINTING OFFICE: 1988 – 202 037/60809

(5)

No. 87-1097

In the Supreme Court of the United States

OCTOBER TERM, 1987

OTIS R. BOWEN, SECRETARY OF HEALTH AND HUMAN SERVICES, PETITIONER

v.

GEORGETOWN UNIVERSITY HOSPITAL, ET AL.

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE DISTRICT OF COLUMBIA CIRCUIT

BRIEF FOR THE PETITIONER

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59 pp

QUESTIONS PRESENTED

1. Whether the Administrative Procedure Act, 5 U.S.C. (& Supp. IV) 551 *et seq.*, prohibits an agency from promulgating retroactive regulations even if the decision to apply a regulation retroactively is not arbitrary, capricious, an abuse of discretion, or otherwise contrary to law.

2. Whether Section 1861(v)(1)(A)(ii) of the Medicare Act, 42 U.S.C. (Supp. III) 1395x(v)(1)(A)(ii), which allows the Secretary of Health and Human Services to promulgate "regulations * * * for the making of suitable retroactive corrective adjustments where, for a provider of services for any fiscal period, the aggregate reimbursement produced by the methods of determining costs proves to be either inadequate or excessive," specifically authorizes the Secretary to promulgate a retroactive regulation establishing a ceiling on reimbursement for hospitals' wage costs, and to apply that regulation in reimbursement proceedings not final at the time that the regulation was promulgated.

PARTIES TO THE PROCEEDING

In addition to the parties named in the caption, Howard University as Howard University Hospital, Tuscon Hospital Liquidating Corp. (formerly Tuscon General Hospital), Greater Southeast Community Hospital, Tuscon Medical Center, St. Cloud Hospital, and Community Hospital of Battle Creek were plaintiffs in actions in the district court. These parties also were appellees in the court of appeals.

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v.

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ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE DISTRICT OF COLUMBIA CIRCUIT

BRIEF FOR THE PETITIONER

OPINIONS BELOW

The opinion of the court of appeals (Pet. App. 1a-19a) is reported at 821 F.2d 750. The opinion and order of the district court (Pet. App. 20a-42a) are unreported.

JURISDICTION

The judgment of the court of appeals (Pet. App. 43a-44a) was entered on June 26, 1987. A petition for rehearing was denied on September 1, 1987 (Pet. App. 45a-46a). On November 23, 1987, Chief Justice Rehnquist extended the time for filing a petition for a writ of certiorari to and including December 30, 1987. The Secretary filed a petition for a writ of certiorari on that date. This Court granted certiorari on February 29, 1988. The jurisdiction of this Court rests upon 28 U.S.C. 1254(1).

STATUTES INVOLVED

5 U.S.C. 551 provides in pertinent part:

For the purpose of this subchapter—

* * * * *

(4) "rule" means the whole or a part of an agency statement of general or particular applicability and future effect designed to implement, interpret, or prescribe law or policy or describing the organization, procedure, or practice requirements of an agency * * *.

42 U.S.C. (Supp. III) 1395x(v)(1)(A) provides in pertinent part:

The reasonable cost of any services shall be the cost actually incurred, excluding therefrom any part of incurred cost found to be unnecessary in the efficient delivery of needed health services, and shall be determined in accordance with regulations establishing the method or methods to be used, and the items to be included, in determining such costs for various types or classes of institutions, agencies, and services; * * *. Such regulations may provide for determination of the costs of services on a per diem, per unit, per capita, or other basis, may provide for using different methods in different circumstances, may provide for the use of estimates of costs of particular items or services, may provide for the establishment of limits on the direct or indirect overall incurred costs or incurred costs of specific items or services or groups of items or services to be recognized as reasonable based on estimates of the costs necessary in the efficient delivery of needed health services to individuals covered by the insurance programs established under this subchapter, and may provide for the use of charges or a percentage of charges where this method

reasonably reflects the costs. Such regulations shall (i) take into account both direct and indirect costs of providers of services (excluding therefrom any such costs, including standby costs, which are determined in accordance with regulations to be unnecessary in the efficient delivery of services covered by the insurance programs established under this subchapter) in order that, under the methods of determining costs, the necessary costs of efficiently delivering covered services to individuals covered by the insurance programs established by this subchapter will not be borne by individuals not so covered, and the costs with respect to individuals not so covered will not be borne by such insurance programs, and (ii) provide for the making of suitable retroactive corrective adjustments where, for a provider of services for any fiscal period, the aggregate reimbursement produced by the methods of determining costs proves to be either inadequate or excessive.

STATEMENT

1. At the time of the events at issue in this case, all "providers" of health care services to Medicare beneficiaries were reimbursed by the Secretary of Health and Human Services (HHS) on an annual basis for the "reasonable costs" of those health care services. 42 U.S.C. (& Supp. III) 1395f(b), 1395x(v) and (v)(1)(A).[1] Congress

[1] Most hospitals are no longer reimbursed for inpatient services to Medicare beneficiaries solely on the basis of the "reasonable cost" incurred in providing services to Medicare patients. In Title VI of the Social Security Amendments of 1983, Pub. L. No. 98-21, §§ 601-607, 97 Stat. 149-172, Congress adopted a new method of reimbursement known as the prospective payment system (PPS). Under PPS (which has been implemented over a four-year transition period beginning on October 1, 1983), hospitals are paid predetermined rates for specific

expressly authorized the Secretary to promulgate regulations "establishing the method or methods to be used, and the items to be included, in determining" reasonable costs (42 U.S.C. (Supp. III) 1395x(v)(1)(A)). Alarmed by dramatic increases in the cost of hospital care, Congress in 1972 amended the statute to authorize the Secretary to "establish[] * * * limits on the * * * costs * * * to be recognized as reasonable" (42 U.S.C. (Supp. III) 1395x(v)(1)(A)). Thus, "based on estimates of the costs necessary in the efficient delivery of needed health services," the Secretary may by regulation limit both the types and amounts of costs that are reimbursable under the Medicare program (42 U.S.C. (Supp. III) 1395x(v)(1)(A)).

In 1979, the Secretary exercised his authority to establish cost limits by promulgating a regulation that prescribed ceilings upon Medicare reimbursement for hospitals' inpatient general routine operating costs. See 44 Fed. Reg. 31806. The regulation divided these costs into two categories: wage costs and all other costs. It fixed maximum reimbursable non-wage costs on a nationwide

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services, which rates are not tied to specific costs incurred by the hospital in providing those services. See 42 U.S.C. (Supp. III) 1395ww(d), as amended by the Consolidated Omnibus Budget Reconciliation Act of 1985, Pub. L. No. 99-272, § 9102, 100 Stat. 155. Many Medicare providers are not covered by the prospective payment system, however, and continue to obtain reimbursement for their "reasonable" costs. See 42 C.F.R. 412.20-412.32 (rehabilitation hospitals, psychiatric hospitals, children's hospitals, and hospitals with average length of stay greater than 25 days are not covered by PPS); 42 C.F.R. 413.1 (reasonable cost payment system applies to skilled nursing facilities, home health agencies, and other facilities providing services other than in-hospital care). Moreover, all providers are reimbursed for some categories of costs on a reasonable cost basis. See, *e.g.*, 42 U.S.C. (& Supp. III) 1395ww(a)(4) (anesthesia services provided by nurse); 42 C.F.R. 412.2(d) (capital costs, direct medical education costs, costs for direct medical and surgical services provided by certain physicians in teaching hospitals).

basis for various categories of hospitals; the rule also set nationwide wage ceilings, but made those cost limits subject to adjustment on a hospital-by-hospital basis to account for variations in wage rates over different geographic areas. The adjustment was made by applying to the nationwide wage cost ceilings an index derived from Bureau of Labor Statistics data for hospital wages in the particular geographic area. A particular hospital's wage cost ceiling was thus dependent upon the index number for that hospital's geographic area. *Id.* at 31807-31808. The wage indices for each geographic area for hospital cost reporting periods beginning on or after July 1, 1979, were set forth in the regulation (*id.* at 31812-31813);[2] the 1980 indices were published one year later (45 Fed. Reg. 41868, 41875-41876).

In 1981, the Secretary adjusted the formula used to calculate the wage indices by excluding data concerning the wages paid by hospitals owned by the federal government. See 46 Fed. Reg. 33638-33639. The Secretary explained that "[b]ecause these hospitals typically use national pay scales, the amounts they pay their employees do not necessarily reflect area wage levels. We believe excluding data from these hospitals will help improve the accuracy of the wage index adjustment" (*id.* at 33639).

The Secretary viewed this refinement in the index methodology as a "minor technical change[]" (46 Fed. Reg. 33638 (1981)). He accordingly did not provide notice or an opportunity to comment before placing the revised index formula into effect. The Secretary further found that the public interest required that the new wage indices be placed into effect immediately (*id.* at 33640).

Several hospitals sought judicial review of the Secretary's action in the United States District Court for

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[2] The Secretary subsequently revised the cost limits for this period (see 44 Fed. Reg. 46949 (1979)).

the District of Columbia, claiming that the Secretary had violated the Administrative Procedure Act (APA), 5 U.S.C. (& Supp. IV) 551 *et seq.*, by failing to provide notice and an opportunity to comment before altering the wage index methodology. The court concluded that "the Secretary's decision to exempt the [decision to alter the index methodology] from notice and comment must be declared unlawful" because it was not supported by "good cause," within the meaning of Section 553(b)(B) of the APA (Pet. App. 58a-60a).[3] Citing the provisions of the Medicare Act limiting the availability of judicial review,[4] the district court declined to issue an injunction barring the application of the 1981 wage indices to the plaintiffs' reimbursement claims. Instead, it entered an order declaring that the revised wage indices were "invalid" (*id.* at 66a). The court observed that the effect of this declaration upon the determination of reimbursement levels for Medicare providers after June 30, 1981, "must be determined in the first instance by the Secretary and her delegates administering the claims procedures" (*id.* at 63a).

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[3] The Secretary did not argue that the annual cost limit schedule is not subject to APA notice and comment requirements and, accordingly, the district court did not address that issue. See Pet. App. 52a n.4. As a matter of internal policy, the Secretary has decided to adhere to APA notice and comment rulemaking procedures in promulgating provider reimbursement regulations under the Medicare Act, notwithstanding the exemption from those requirements under the APA for public property, loans, grants, benefits or contracts. See 5 U.S.C. 553(a)(2); 36 Fed. Reg. 2532 (1971); *Humana of South Carolina, Inc.* v. *Califano*, 590 F.2d 1070, 1082-1084 (D.C. Cir. 1978).

[4] Under 42 U.S.C. (& Supp. III) 1395*oo*(f)(1), a Medicare provider who is dissatisfied with the amount of reimbursement it has obtained may not seek judicial review until it has submitted its claim for additional compensation to the Provider Reimbursement Review Board. See *Bethesda Hosp. Ass'n* v. *Bowen*, No. 86-1764 (Apr. 4, 1988), slip op. 7-8.

Rather than appeal this decision, the Secretary elected to cure the procedural defect identified by the district court. In February 1984, the Secretary issued a notice of proposed rulemaking in which she proposed to reissue the 1981 wage indices and invited comment thereon. See 49 Fed. Reg. 6175. The notice stated that the indices set forth in the proposed rule would apply to cost reporting periods beginning on or after July 1, 1981 and ending after September 30, 1981, but would not apply to reporting periods beginning on or after October 1, 1982 (*ibid.*).[5] Thus, "the rule was to apply to cost accounting periods that would have been covered prospectively by the Secretary's 1981 rule had that rule been promulgated in accordance with the procedural requirements of the APA" (Pet. App. 9a).

The Secretary stated (49 Fed. Reg. 6177 (1984)) that

> the exclusion of Federal government hospital data would improve the accuracy of the wage index because most Federal hospitals characteristically employ physicians and other high salaried professionals whose salaries are based on national rather than local wage scales. This factor tends to overstate the average hospital wage in areas with Federal institutions as compared to areas without such Federal facilities. Since the purpose of the wage index is to reflect area-by-area differences in the labor-related component of hospital costs, the exclusion of Federal hospital data better enables the wage index to accurately reflect area-by-area labor-related costs.

The Secretary observed that where non-federal hospitals pay wages similar to those paid by the federal government, the data from non-federal hospitals would reflect those wages, and "the exclusion of Federal wages would have

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[5] Reimbursement of routine inpatient costs for those later cost periods is governed by different rules. See 49 Fed. Reg. 6175 (1984).

little effect on the wage index" (*ibid.*). If, on the other hand, "wages paid to Federal hospital employees are higher than most area hospital wage levels, then the inclusion of Federal data results in most hospitals receiving a higher Medicare cost limit than is warranted based on their expected costs. Such a result defeats the purpose of the cost limits, which is to limit a provider's reimbursement to only those costs necessary in the efficient delivery of needed health services." *Ibid.*

The Secretary stated that the reissuance of the 1981 wage indices, which had been calculated without wage data from federally-owned hospitals, "avoids placing an unwarranted hardship and burden on intermediaries and many hospitals, while it would impose only a minimal burden on a few hospitals" (49 Fed. Reg. 6177 (1984)). Because "[t]he inclusion of Federal data in the wage index at this point in time would result in overpayments to many hospitals," intermediaries might be forced to review already-settled cost reports and hospitals that had received excess reimbursement would be required to repay these sums to the government (*ibid.*). "In contrast, those few hospitals that would receive less reimbursement if Federal hospital data are excluded from the wage index would not be unduly harmed or burdened by the reissuance of the wage index," because those hospitals could only have relied on the wage indices published in 1981 (*ibid.*). "Since these limits are prospectively established and published in advance, all hospitals knew before the beginning of their respective cost reporting periods what their cost limit would be. * * * This proposed notice would simply put the previously set cost limits back into effect." *Ibid.*

After considering comments submitted by interested parties, the Secretary reaffirmed the propriety of the change in index methodology and reissued the 1981 wage indices in final form (49 Fed. Reg. 46495 (1984)). She rejected the contention that the application of the 1984 rule

to 1981 cost years constituted an impermissible retroactive rule, observing that "as a practical matter hospitals could only have relied on the [1981] rule in determining their respective cost limits" for the cost periods that would be covered by the 1984 rule (*id.* at 46497). Because "[e]ach hospital [therefore] knew in advance of its cost reporting period what its cost limit would be for this period," the Secretary concluded that the 1984 rule could properly be applied to 1981 cost reporting periods (*ibid.*).

2. Respondents are health care providers that stand to receive greater compensation if federal wage cost data were included in their wage cost index for 1981 than if federal data are excluded. After the Secretary reissued the original 1981 wage indices, respondents' fiscal intermediaries recouped funds previously reimbursed to respondents under wage indices that included federal hospital wage data. Respondents thereupon obtained the necessary certification from the Provider Reimbursement Review Board and commenced several actions in the United States District Court for the District of Columbia challenging the Secretary's decision to apply the revised index calculation methodology to their 1981 cost periods (see 42 U.S.C. (Supp. III) 1395*oo*(f)(1)). The district court consolidated the actions and entered judgment in favor of respondents. The court declined to address respondents' claims that the Secretary lacked the statutory authority to issue retroactive rules. Instead, the court held that the Secretary could not properly apply the 1981 wage indices retroactively on the facts of this case. See Pet. App. 20a-42a.

In so ruling, the district court applied the five-factor balancing test set forth in *Retail, Wholesale & Dep't Store Union* v. *NLRB*, 466 F.2d 380, 390 (D.C. Cir. 1972). The court concluded (Pet. App. 38a) that "the balancing of factors in this case compels the conclusion that Medicare statute interests are only minimally served, if at all, by

the Secretary's retroactive application of his reissued wage index to recoup funds from these plaintiffs. In contrast, the ill effects of the Secretary's actions are substantial for these plaintiffs and for the general integrity of the administrative rule-making process. Accordingly, retroactive application against these plaintiffs must be denied."

3. The court of appeals affirmed, but rested its decision upon grounds different from those adopted by the district court (Pet. App. 1a-19a). The court acknowledged that adjudicatory orders issued by administrative agencies may be given retroactive effect. But, citing the Administrative Procedure Act's definition of a "rule" as "an agency statement of general or particular applicability and *future effect*" (5 U.S.C. 551(4) (emphasis added)), the court concluded that "the APA requires that legislative rules be given future effect only. Because of this clear statutory command, equitable considerations are irrelevant to the determination of whether the Secretary's rule may be applied retroactively; such retroactive application is foreclosed by the express terms of the APA" (Pet. App. 13a; see *id.* at 11a-12a).

The court stated that when the district court invalidated the 1981 rule, "it necessarily reinstated the Secretary's *1979* rule, which required the Secretary to reimburse providers using a formula that included federal-hospital data" (Pet. App. 13a (emphasis in original)). "The Secretary's 1984 rule obviously can have no application to cost accounting periods that were, by virtue of the District Court's ruling, governed by the Secretary's 1979 rule" (*ibid.*). In the court's view, "agencies would be free to violate the rulemaking requirements of the APA with impunity if, upon invalidation of a rule, they were free to 'reissue' that rule on a retroactive basis" (*id.* at 14a). The court acknowledged that if an agency rule is invalidated on procedural grounds, "the agency must, of course, be given an opportunity to correct the procedural defect and promulgate a new rule"; but "the corrected rule, like all other legislative rules, [must] be prospective in effect only" (*ibid.*).[6]

The court of appeals acknowledged that Congress may "override the general terms of the APA by explicitly authorizing retroactive regulations in an agency's organic statute" (Pet. App. 14a). The court of appeals, however, rejected petitioner's contention that the retroactive 1984 regulation was specifically authorized by Section 1861(v)(1)(A)(ii) of the Medicare Act, 42 U.S.C. (Supp. III) 1395x(v)(1)(A)(ii), which empowers the Secretary of Health and Human Services to issue "regulations" that "provide for the making of suitable retroactive corrective adjustments where * * * the aggregate reimbursement produced by the methods of determining costs proves to be either inadequate or excessive." According to the court of appeals, the Secretary could not rely on the retroactive adjustments provision to support the 1984 rule because the provision was not explicitly cited by the agency in promulgating that rule (Pet. App. 16a). The court stated that "[i]t was not until the litigation in the District Court that the Secretary sought to invoke the retroactive adjustments provision as authority for the rule" (*ibid.*).

In any event, the court held, "Congress did *not* intend to empower the Secretary to promulgate retroactive cost-limit rules" (Pet. App. 15a (emphasis in original)). The court discerned "a critical distinction between the power to promulgate retroactive rules of general application and the power to make retroactive corrective adjustments in the

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[6] In its order denying the petition for rehearing, the court of appeals stated that "[a]s a general rule, the APA requires that legislative rules be given future effect only. Whatever exceptions might exist to this general rule were not implicated in the case before us. Our opinion therefore does not purport to address circumstances in which there may be an exception to the rule against retroactive rulemaking." Pet. App. 45a.

reimbursements of particular providers whose aggregate reimbursements are shown to be either 'inadequate or excessive' " in case-by-case evidentiary proceedings (*id.* at 17a). It concluded that Section 1861(v)(1)(A)(ii) confers only the latter power upon the Secretary, authorizing him to make retroactive adjustments to individual reimbursement determinations where he is able to "prove that inadequate or excessive reimbursements to a provider have resulted from his 'methods of determining costs' " (Pet. App. 18a (citation omitted)). Where, as in this case, there is no individualized proof that the reimbursement awarded respondents exceeded their reasonable costs, the court held that the Secretary has no authority to adjust those reimbursement awards retroactively (*id.* at 18a-19a).

SUMMARY OF ARGUMENT

A. The court of appeals' decision in this case rests on two untenable propositions: (1) that a court order invalidating an agency rule on procedural grounds automatically reinstates the agency's prior rule and thereby precludes any subsequent retroactive rulemaking; and (2) that a "retroactive application [of agency rules] is foreclosed by the express terms of the APA" (Pet. App. 13a). Both propositions are inconsistent with established tenets of federal administrative law.

When a reviewing court sets aside an agency rule because of a procedural violation, the court's order does not finally determine what rule should apply. Such an order simply rejects one attempt by the agency to answer that question and does not deprive the agency of its congressionally-delegated responsibility to reexamine the issue on remand. Indeed, an agency's authority to engage in curative rulemaking is well-settled.

Moreover, neither the APA's definition of "rule" nor its legislative history supports the court's and respondents'

view that the APA bars retroactive rulemaking. The reference to "future effect" in the definition of "rule" merely expresses the notion that a rule is a statement of law or policy that is not applied in the same proceeding in which it is announced; any application or enforcement will occur *only in the future*. Indeed, the legislative history reveals that Congress understood that the "future effect" of a rule might well include an effect on past transactions and that Congress considered, and rejected, the very prohibition on retroactive rulemaking that respondents and the court of appeals now read into the APA.

Nor does the Medicare Act itself specifically prohibit the Secretary from promulgating retroactive cost limit rules following judicial invalidation of cost limit rules previously proposed by the Secretary. The provision of the statute authorizing the Secretary to adopt cost limit rules, which was enacted in 1972, does not speak to this question. Although the legislative history reflects Congress's understanding that cost limit rules would generally operate prospectively, there is no suggestion that Congress intended to curb the Secretary's discretion to promulgate retroactive rules where a court has invalidated the Secretary's previous rules because of procedural violations.

In our view, the Secretary has general rulemaking authority under the Medicare Act to promulgate a retroactive cost limit rule so long as his decision is not arbitrary, capricious, an abuse of discretion, or otherwise contrary to law. Where, as in this case, the retroactive regulation is "curative" in character—that is, it merely cures a procedural error in a prior rule without changing its substance—then the element of unfair surprise often associated with retroactive lawmaking is simply not present. Respondents had adequate notice that the reasonableness of their costs would be assessed against the substantive standard of the 1984 rule because that rule simply

adopted the same standard as the 1981 rule, which was in place when respondents incurred their costs. On the other hand, if the retroactive cost limit is not upheld, respondents will receive a windfall at the taxpayers' expense. Thus, there can be no contention that the Secretary's decision to issue a retroactive rule is arbitrary and capricious.

B. The decision of the court of appeals is also wrong because, wholly apart from the Secretary's general rulemaking authority under the Medicare Act, the Secretary has properly construed Section 1861(v)(1)(A)(ii) of the Medicare Act as authorizing retroactive regulations establishing a cost limit ceiling. Section 1861(v)(1)(A)(ii) allows the Secretary to promulgate "regulations * * * for the making of suitable retroactive corrective adjustments where, for a provider of services for any fiscal period, the aggregate reimbursement produced by the methods of determining costs proves to be either inadequate or excessive." In this case, the prior (1979) cost limit rule constitutes "the method[] of determining costs" that the Secretary has deemed to cause "excessive" reimbursement, and the retroactive regulation challenged in this case is for the express purpose of making a "retroactive corrective adjustment[]" in such reimbursement. Because the statutory language "admits of" the Secretary's construction, which is not contradicted by the legislative history and which offers a sensible implementation of Congress's purpose, it must be upheld. See *Young* v. *Community Nutrition Inst.*, 476 U.S. 974, 981 (1986); *Chevron U.S.A. Inc.* v. *NRDC, Inc.*, 467 U.S. 837, 842-844 (1984).

ARGUMENT

I. NEITHER THE ADMINISTRATIVE PROCEDURE ACT NOR THE MEDICARE ACT BARS THE SECRETARY OF HEALTH AND HUMAN SERVICES FROM PROMULGATING A RETROACTIVE COST LIMIT RULE PURSUANT TO HIS GENERAL RULEMAKING AUTHORITY UNDER THE MEDICARE ACT

The Secretary's 1984 cost limit rule is a valid exercise of his general rulemaking authority under the Medicare Act. See 42 U.S.C. (& Supp. III) 1395x(v)(1)(A), 1395hh, 1395ii. Respondents appear to argue (see Br. in Opp. 5-6) that the effect of the 1983 district court order, which invalidated the Secretary's 1981 rule (see Pet. App. 49a-64a), was to reinstate the agency rule that predated the invalidated rule. For this reason, they suggest, the Secretary lacked authority on remand to promulgate a new retroactive rule. Respondents further contend that retroactive cost limit rules are barred by the APA's definition of a rule and by the legislative history of the 1972 amendments to the Medicare Act. Each of these claims is without foundation.

A. The District Court's 1983 Order, Which Invalidated the Secretary's 1981 Rule, Did not Reinstate the Secretary's Prior 1979 Rule so as to Prohibit, on Remand, the Secretary's Promulgation in 1984 of a Retroactive Rule

Respondents contend that the Secretary's failure to appeal the district court's invalidation of its 1981 rule reinstated the Secretary's prior 1979 rule and precluded any subsequent retroactive rulemaking. Respondents, however, fundamentally misapprehend the scope of an agency's authority on remand from a court order invalidating an agency rule on procedural grounds. They also ignore the traditional role of curative rulemaking.

1. Contrary to respondents' contention (Br. in Opp. 5-6; see also Pet. App. 13a), a decision by a reviewing court

setting aside an agency rule because of procedural irregularities does not finally decide the question what rule should apply. It merely rejects one attempt by the agency to answer that question. On remand, the agency retains authority "to deal with the problem afresh, performing the function delegated to it by Congress"; the fact that the agency committed a procedural error in its prior endeavor does not confer on anyone a "vested right" in any particular regulatory outcome on remand. *SEC* v. *Chenery Corp.*, 332 U.S. 194, 200-201 (1947);[7] see *Burlington Northern Inc.* v. *United States*, 459 U.S. 131, 142 (1982); *NLRB* v. *Food Store Employees Union, Local 347*, 417 U.S. 1, 10 (1974); *FPC* v. *Idaho Power Co.*, 344 U.S. 17, 20 (1952); *Addison* v. *Holly Hill Fruit Products, Inc.*, 322 U.S. 607, 619-622 (1944); see also *Motor Vehicle Mfrs. Ass'n of the United States* v. *State Farm Mutual Auto. Ins. Co.*, 463 U.S. 29, 57 & n.21 (1983).

Respondents' contention is not only contrary to well-established tenets of administrative law, it is also unworkable. If an order of a reviewing court setting aside an agency rule on procedural grounds reinstates the agency's prior rule, and precludes further attempts by the agency to

[7] Respondents' argument is identical to the argument that this Court rejected in *Chenery*. Previously, in *SEC* v. *Chenery Corp.*, 318 U.S. 80 (1943), the Court set aside as inadequately justified an order of the Securities and Exchange Commission and had directed that the case be remanded to the Commission for futher proceedings. Upon reexamining the problem, the Commission reached the same result. In rejecting respondents' claim that the Court's initial decision precluded the Commission's decision, the Court stated that its prior decision held "no more and no less than that the Commission's first order was unsupportable for the reasons supplied by that agency" (332 U.S. at 200). The Court explained that "[t]he fact that the Commission had committed a legal error in its first disposition of the case certainly gave [the respondents] no vested right" and on remand "therefore, the Commission was bound to deal with the problem afresh, performing the function delegated to it by Congress" (*id.* at 200-201).

modify the prior rule other than prospectively, the result would be that the *court* rather than the agency would have determined agency policies for the period covered by the procedurally-flawed rule. Such a result is particularly anomalous in that the reinstated rule is one that the agency has already found to be unsatisfactory and which, indeed, may even be contrary to intervening statutory provisions. Moreover, this result would force agencies to seek review of many more lower court decisions invalidating regulations because of procedural defects in order to protect their regulatory authority. There is no warrant for this kind of judicial intrusion into agency policymaking prerogatives. An agency should be permitted to exercise its discretion following a remand to determine in the first instance the suitable course of action. Cf. *Vermont Yankee Nuclear Power Corp.* v. *NRDC, Inc.*, 435 U.S. 519 (1978) (holding that a court may not impose procedural requirements on an agency on remand beyond those required by statute).

Accordingly, the district court's 1983 order invalidating the Secretary's 1981 rule did not finally decide the question of the appropriate standard to be applied in calculating the wage cost reimbursement owed to respondents under the Medicare program. The court's order simply rejected—on procedural grounds—one answer to that question. The Secretary therefore retained his authority "to deal with the problem afresh, performing the function delegated to [him] by Congress" (*SEC* v. *Chenery Corp.*, 332 U.S. at 200-201).[8] He was not required to appeal the 1983 district

[8] The district court refused to issue an order barring the Secretary from applying the 1981 rule to respondents' reimbursement claims, holding that the provisions of the Medicare statute requiring exhaustion of administrative remedies deprived the court of authority to issue such an order. The court expressly stated that respondents' claims were left to be adjudicated in the administrative process. See Pet. App. 62a-64a.

court order to preserve his authority to promulgate the same rule after correcting the procedural error.

Nor is there any merit to respondents' claim (Br. in Opp. 8), that this deprives them of the "fruits of their victory." Respondents did not challenge the substance of the 1981 rule (see Pet. App. 51a), which was set aside solely because of procedural deficiencies. Consequently, the only "fruit" to which respondents are entitled is notice and an opportunity to comment as provided by 5 U.S.C. 553—which they in fact received on remand. Respondents cannot convert an exclusively procedural victory into a substantive victory on the merits that entitles them, in contravention of Congress's mandate, to reimbursement for costs inefficently incurred.

2. In addition, contrary to respondents' claim (Br. in Opp. 7), the Secretary's 1984 rule does not make "a mockery of" administrative procedure by reenacting without substantive change the Secretary's 1981 rule. There is nothing inherently suspect or improper about such a procedure. Quite the opposite is true; courts have long upheld similar exercises in "curative" lawmaking because they do *not* raise any of the problems of inadequate notice generally associated with retroactive rules.

As this Court observed in *Graham & Foster* v. *Goodcell*, 282 U.S. 409, 429 (1931), which concerned the analogous question of the validity of curative legislation, a distinction must be drawn "between a bare attempt of the legislature retroactively to create liabilities for transactions * * * fully consummated in the past * * * and the case of a curative statute aptly designed to remedy mistakes and defects in the administration of government where the remedy can be applied without injustice." Curative acts "impair[] no substantial right or equity" and are "free of the elements of novelty and surprise which have led to condemnation, as unreasonable and arbitrary, of other retroactive legislation." *Swayne & Hoyt, Ltd.* v. *United States*,

300 U.S. 297, 302 (1937); see *Forbes Pioneer Boat Line* v. *Board of Comm'rs*, 258 U.S. 338 (1922); *United States* v. *Heinszen & Co.*, 206 U.S. 370 (1907); see also *Van Emmerik* v. *Janklow*, 454 U.S. 1131 (1982) (White & Blackmun, JJ., dissenting from dismissal of appeal). "It is when things go wrong that the retroactive statute often becomes indispensable as a curative measure; though the proper movement of law is forward in time, we sometimes have to stop and turn about to pick up the pieces." L. Fuller, *The Morality of Law* 53 (rev. ed. 1969).[9]

For similar reasons, "[t]he retroactive curing, without change of content, of a defective regulation seems the least objectionable application of administrative retroactivity." Note, *Retroactive Operation of Administrative Regulations*, 60 Harv. L. Rev. 627, 628 (1947); cf. *Holly Hill Fruit Products, Inc.*, 322 U.S. at 621. The circumstances of this case well illustrate why curative retroactive rules do not raise the same concerns about prejudice and unfair surprise associated with other forms of retroactive rules. The wage indices at issue here were initially promulgated as an entirely prospective regulation issued in 1981. When

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[9] See generally, Hochman, *The Supreme Court and the Constitutionality of Retroactive Legislation*, 73 Harv. L. Rev. 692, 705-706 (1960) (quoting *Danforth* v. *Groton Water Co.*, 178 Mass. 472, 477, 59 N.E. 1033, 1034 (1901)) ("The Court's favorable treatment of curative statues is probably explained by the strong public interest in the smooth functioning of government. It is necessary that the legislature should be able to cure inadvertent defects in statutes or their administration by making what has been aptly called 'small repairs.' Moreover, the individual who claims that a vested right has arisen from the defect is seeking a windfall since, had the legislature's or administrator's action had the effect it was intended to and could have had, no such right would have arisen."); Slawson, *Constitutional and Legislative Considerations in Retroactive Lawmaking*, 48 Cal. L. Rev. 216, 239 (1960); Munzer, *A Theory of Retroactive Legislation*, 61 Tex. L. Rev. 425, 470 (1982); W. Gellhorn, *Administrative Law* 300-301 (1940).

that regulation was invalidated by the district court on procedural grounds in 1983, the Secretary decided not to appeal that determination; instead—after subjecting the regulation to prior notice and comment—she reissued the 1981 regulation in 1984. Because the 1984 regulation adopted the identical substantive standard as had been adopted in 1981, all hospitals affected by the 1984 rule—including respondents—were plainly on notice before they incurred the costs subject to the 1984 rule that the reasonableness of those costs would be measured against the standards contained in that rule. No serious hardship therefore results from the 1984 retroactive rule. To the contrary, because more hospitals are benefited by the rule than are burdened, a hardship would result absent retroactivity. See 49 Fed. Reg. 6177 (1984).

3. Finally, there is no merit to the court of appeals' assertion that "agencies would be free to violate the rulemaking requirements of the APA with impunity if, upon invalidation of a rule [based on a procedural defect], they were free to 'reissue' that rule on a retroactive basis" (Pet. App. 14a). A decision by a reviewing court invalidating a rule for failure to conform to the procedural requirements of the APA means, at the very least, that the agency must follow those procedures before it repromulgates its rules. By affording the required procedures on remand the agency has not violated the law "with impunity"—it has *corrected* the legal error.

Moreover when an agency is required to conduct new rulemaking proceedings that are free from procedural defects, it must consider any information obtained during those proceedings, and respond to significant comments made. See *State Farm Mutual Auto. Ins. Co.*, 463 U.S. at 43. The agency may be persuaded by such comments to adopt a different rule. Or, it may decide, based on the new

administrative record generated by those proceedings, to adopt the same substantive rule. In either event, its decision will be subject to further review under the arbitrary and capricious standard of the APA. See 5 U.S.C. 706(2)(A). Moreover, where the agency decides, as the Secretary did here, to apply the new rule retroactively, it must defend its decision to do so under that same standard of review. As discussed (pages 36-40, *infra*), the Secretary's decision to adopt a retroactive rule in 1984 was not arbitrary and capricious.

B. The Administrative Procedure Act Does not Bar Retroactive Regulations

Congress passed the APA in 1946, over 40 years ago. Until the court of appeals' decision in this case, however, no court appears to have construed the APA to impose what amounts to a complete ban on retroactive rules, including the promulgation of curative regulations, such as those challenged in this case.[10] Courts[11] and com-

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[10] The court of appeals initially stated that all retroactive rules were prohibited by the APA (Pet. App. 13a). In its order denying the petition for rehearing, the court indicated that there might be some exceptions to this "general rule," but declined to state what those exceptions might be (*id.* at 45a). That vague order does nothing to eliminate the fundamental error in the court's legal analysis—the conclusion that the APA's definition of a "rule" imposes an independent limitation upon retroactive rulemaking.

[11] See, *e.g.*, *Texaco, Inc.* v. *Department of Energy*, 795 F.2d 1021, 1025-1027 (Temp. Emer. Ct. App.), cert. dismissed, 478 U.S. 1030 (1986); *Daughters of Miriam Center for the Aged* v. *Mathews*, 590 F.2d 1250, 1259-1260 (3d Cir. 1978) (interpretative rule); *National Helium Corp.* v. *FEA*, 569 F.2d 1137, 1145 n.18 (Temp. Emer. Ct. App. 1977); see also *National Ass'n of Indep. Television Producers & Distributors* v. *FCC*, 502 F.2d 249, 255 nn.10 & 11 (2d Cir. 1974); *General Telephone Co.* v. *United States*, 449 F.2d 846, 863 (5th Cir. 1971); cf. *Illinois* v. *Bowen*, 786 F.2d 288, 292-293 (7th Cir. 1986) (retroactive application of a new interpretation of an administrative

mentators[12] alike have instead generally expressed the view—which is consistent with principles of administrative law pre-dating the APA[13]—that agencies may promulgate

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regulation). Even prior decisions of the District of Columbia Circuit were to the same effect. See *Citizens To Save Spencer County* v. *EPA*, 600 F.2d 844, 879-881 (1979); see also *Maxcell Telecom Plus, Inc.* v. *FCC*, 815 F.2d 1551, 1554-1556 (1987).

[12] See, *e.g.*, 2 K. Davis, *Administrative Law* § 7.23, at 109 (2d ed. 1979) ("[R]etroactive rules are valid if they are reasonable but are invalid if their retroactivity is unreasonable in the circumstances."); Davis, *Administrative Rules—Interpretative, Legislative, and Retroactive*, 57 Yale L.J. 919, 921 (1948); F. Cooper, *Administrative Agencies and the Courts* 285 (1951) ("If it is a legislative regulation, it is normally competent for the agency to amend its regulation, just as it is proper for a legislature to amend a statute; and there is normally nothing to prevent the amended regulation being applied in situations where it has retroactive effects.").

[13] See, *e.g.*, *Addison* v. *Holly Hill Fruit Products, Inc.*, *supra*; *Porter* v. *Senderowitz*, 158 F.2d 435 (3d Cir. 1946) (retroactive price order), cert. denied, 330 U.S. 848 (1947); 1 F. Vom Baur, *Federal Administrative Law* § 493, at 491 (1942) (footnote omitted) ("In general, an administrative regulation may not be applied retroactively. However, where an original regulation is invalid because not consistent with the statute or unreasonable, a valid amended regulation becomes the primary and controlling rule in respect of the situation presented, even as to past transactions."); Lee, *Legislative and Interpretative Regulations*, 29 Geo. L.J. 1, 29 (1940) (footnote omitted) ("The administrative officer or agency should be able to amend its prior legislative regulation just as Congress may amend its prior legislation. As a matter of law it should even be possible to do this with retroactive effect subject to the limits of the Fifth Amendment due process clause on retroactive legislation and to the limitations, if any, expressed or implied in the particular statutory grant of the power to prescribe legislative regulations."); see also *Miller* v. *United States*, 294 U.S. 435, 439 (1935); *Twin City Milk Producers Ass'n* v. *McNutt*, 123 F.2d 396, 398 (8th Cir. 1941) (see *Twin City Milk Producers Ass'n* v. *McNutt*, 122 F.2d 564 (8th Cir. 1941)).

This Court's decision in *Arizona Grocery Co.* v. *Atchison, T. & S.F. Ry.*, 284 U.S. 370 (1932) is not to the contrary. The Court ruled

retroactive rules so long as their retroactive effect is reasonable and not otherwise barred by law. Cf. *Heckler* v. *Community Health Services*, 467 U.S. 51, 60 n.12 (1984) ("an administrative agency may not apply a new rule retroactively when to do so would unduly intrude upon reasonable reliance interests"). Nothing in the language, structure, or legislative history of the APA supports the contrary view urged by respondents and embraced by the court of appeals.

1. The APA defines "rule" as "an agency statement of general or particular applicability and future effect" (5 U.S.C. 551(4)). Contrary to the court of appeals' ruling, however, the inclusion of the words "future effect" in this definition does not bar retroactive rulemaking. The "future effect" of a rule, in the context of Section 551(4),

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in that case that the Interstate Commerce Commission, having prescribed a maximum reasonable rate, "may not at a later time, and upon the same or additional evidence as to the fact situation existing when its previous order was promulgated, by declaring its own finding as to reasonableness erroneous, subject a carrier which conformed thereto to the payment of reparation measured by what the Commission now holds it should have decided in the earlier proceeding to be a reasonable rate" (*id.* at 390). The Court's ruling, however, did not depend on the general principle that rules can operate only prospectively. Rather, the Court indicated that under the facts of that case, the Commission, like "the legislature itself," could not "substitute a new rule of conduct" to govern the past transaction (*id.* at 389). Hence, the Court's ruling appears to rest on constitutional considerations.

Whether or not the Court's intimation in *Arizona Grocery* that Congress would have been without constitutional authority to enact a retroactive order accurately reflected constitutional doctrine at that time, this Court's jurisprudence has since clearly evolved. See, *e.g.*, *Usery* v. *Turner Elkhorn Mining Co.*, 428 U.S. 1 (1976). But in any event, the type of concerns raised in *Arizona Grocery*, where the federal agency dramatically changed the *substance* of a prior, specifically-drawn rule and applied its new rule retroactively, is plainly not implicated here, where the Secretary merely promulgated a curative rule that did not differ substantively from his earlier (1981) rule.

refers simply to *when* a rule applies, not to *what* transactions, whether past or present, it applies. A rule does not govern anything until it is legally "effective." Hence, a rule may, as in this case, be effective in the future, yet, once effective, concern transactions that were completed prior to its effective date. See 49 Fed. Reg. 46495 (J.A. 29).[14]

The reference to "future effect" therefore serves simply to distinguish rulemaking from adjudication, not to prohibit retroactive regulations as a matter of law. In this respect, the APA adheres to the traditional view, which is that a legislative "rule" is a statement of law or policy that is not applied or enforced in the same proceeding in which it is announced; any application or enforcement occurs *only in the future, i.e.,* in an adjudication. Cf. J. Dickinson, *Administrative Justice and the Supremacy of Law* 21 (1927) (emphasis added) ("What distinguishes legislation from adjudication is that the former * * * *must be applied in a further proceeding* before the legal position of any particular individual will be definitely touched by it * * *."); *id.* at 15 n.25 (emphasis added) (administrative regulations "lay down general rules and leave them to be applied *in a later proceeding* to the facts of particular cases"); see also Davis, *supra,* 57 Yale L.J. at 921.

The structure of the APA supports this view. Section 553(d) shows that Congress was aware of the distinction between when a rule is effective and whether a rule, once

[14] See Shapiro, *The Choice of Rulemaking or Adjudication in the Development of Administrative Policy,* 78 Harv. L. Rev. 921, 953 (1965) (footnotes omitted) ("Section 2(c) of the [APA] defines a 'rule' as any agency statement of 'future effect,' but this provision has never specifically been held to preclude a regulation from having a retrospective effect or from upsetting reliance interests based on prior policy. Nor is the provision of section 4(c), stating that certain regulations cannot take effect in less than thirty days after publication, controlling. * * * [T]he effective date of a regulation does not necessarily govern its impact.").

effective, applies to past or present transactions. It also shows that Congress spoke only to the first issue in the APA. Section 553(d) provides that "[t]he required publication or service of a substantive rule shall be made not less than 30 days before its effective date" except in certain specified circumstances.[15] Congress's intention in Section 553(d) to ensure a future "effective date" for agency rules is consistent with its defining a rule in terms of its "future effect" in Section 551(4). Neither statutory provision touches on the question whether a rule, once effective, may govern past transactions or events.[16]

2. The legislative history also refutes respondents' proposed construction of the APA. It shows that Congress considered and rejected proposals to ban retroactive regulations, possibly out of concern that such a ban would be overly broad and would call into question the propriety of the very type of curative rulemaking engaged in by HHS in this case. In addition, the legislative history of Congress's adoption of the "future effect" language in the definition of a rule makes clear that Congress did not equate that language with the absence of retroactivity.

[15] The requirement of a 30-day delay in effectiveness does not apply to: "(1) a substantive rule which grants or recognizes an exemption or relieves a restriction; (2) interpretative rules and statements of policy; or (3) as otherwise provided by the agency for good cause found and published with the rule" (5 U.S.C. 553(d)).

[16] The statutory context of the "future effect" language upon which respondents rely likewise renders their interpretation of the APA implausible. The relevant provision, Section 551(4), is part of an introductory provision defining the Act's terms, including the meaning of "rule." For that reason, Section 551(4) cannot fairly be characterized as prohibiting rules without "future effect"; at most, the provision would, under respondents' reading, express congressional intent that a statement of agency policy or law lacking in future effect is not a "rule," within the meaning of the APA. In no event therefore does Section 551(4) support the court of appeals' much broader ruling that the APA bars regulations that operate retroactively.

a. The enactment of the APA in 1946 was the culmination of over eight years of careful study and debate involving the Congress, Executive Branch, and private bar. See generally *Wong Yang Sung* v. *McGrath,* 339 U.S. 33, 36-41 (1950); H.R. Rep. 1980, 79th Cong., 2d Sess. 6-15 (1946), *reprinted in* Senate Comm. on the Judiciary, 79th Cong., 2d Sess., *Administrative Procedure Act—Legislative History* 233, 241-250 (1946) [hereinafter *APA Leg. Hist.*]; *Attorney General's Manual on the Administrative Procedure Act* 5-7 (1947) [hereinafter *Attorney General's Manual*]. The Senate and House held lengthy hearings on proposed legislation.[17] A Committee appointed by the Attorney General undertook an in-depth study of federal administrative law, which resulted in the publication of a final Committee Report along with 27 monographs on the practices of various administrative agencies.[18] And the American Bar Association (ABA) and the National Conference of Commissioners on Uniform State Laws each debated and developed their own proposed model federal administrative procedure acts.[19]

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[17] See *Administrative Law: Hearings Before Subcomm. No. 4 of the House Comm. on the Judiciary,* 76th Cong., 1st Sess. (1939); *Administrative Procedure: Hearings Before A Subcomm. of the Senate Comm. on the Judiciary,* 77th Cong., 1st Sess. Pts. 1-4 (1941); *Administrative Procedure: Hearings Before the House Comm. on the Judiciary,* 79th Cong., 1st Sess. (1945) [hereinafter *1945 House Hearings*].

[18] See *Administrative Procedure in Government Agencies,* S. Doc. 186, 76th Cong., 3d Sess. Pts. 1-13 (1940) (monograph of the Attorney General's Committee on Administrative Procedure); *Administrative Procedure in Government Agencies,* S. Doc. 10, 77th Cong., 1st Sess. Pts. 1-14 (1941) (same); *Administrative Procedure in Government Agencies,* S. Doc. 8, 77th Cong., 1st Sess. (1941) (Report of the Attorney General's Committee).

[19] See Commentaries, 30 A.B.A. J. 6-7, 181, 185-193, 226-229 (1944); *Handbook of the National Conference of Commissioners on Uniform State Laws* 226-231 (1943) [hereinafter *1943 Handbook*];

In the course of these exhaustive deliberations, Congress did not overlook the issue of retroactive rules. Indeed, several congressmen and the ABA proposed that retroactive rules should be expressly barred except in limited circumstances. Significantly, the wording of their proposals confirms that those in Congress who wished to prohibit retroactive rules understood the difference between retroactivity and legal effectiveness, and accordingly took care specifically to proscribe the former and to require that the latter did not occur until after publication of the rule. Their bills typically provided that "[n]o rule or order shall be retroactive *or* effective prior to its publication or service unless such effect is both expressly authorized by law and required for good cause." H.R. 5237, 78th Cong., 2d Sess. § 5(e) (1944) (emphasis added); H.R. 339, 79th Cong., 1st Sess. § 5(e) (1946) (same); H.R. 1117, 79th Cong., 1st Sess. § 5(e) (1946) (same); S. 2030, 78th Cong., 2d Sess. § 5(e) (1944) (same except no "expressly"); H.R. 5081, 78th Cong., 2d Sess. § 5(e) (1944) (no "expressly"); see Commentary, 30 A.B.A. J. 229 (1944) (no "expressly").

Congress, however, omitted any reference to "retroactive" rules in the version ultimately enacted. As described above, Section 553(d) provides only that a legislative rule is, except in limited circumstances, not legally "effective" until 30 days after its publication in the Federal Register. Congress's deliberate omission of the reference to retroactive rules is strong, if not dispositive, evidence that it did not intend to bar retroactive rulemaking in the APA. Cf. *Bowen* v. *Galbreath,* No. 86-1146 (Feb. 24, 1988), slip op. 3.

Moreover, there is reason to believe that Congress understood that, absent such an explicit statutory prohibi-

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Handbook of the National Conference of Commissioners on Uniform State Laws 106-109, 329 (1944) [hereinafter *1944 Handbook*].

tion, agencies would have the power to promulgate retroactive rules in appropriate cases. Courts and commentators alike then recognized that agencies had the authority to promulgate retroactive rules (see note 13, *supra*) Indeed, in 1944, during congressional consideration of the APA, this Court held that a federal agency should engage in retroactive rulemaking. See *Addison* v. *Holly Hill Fruit Products, Inc., supra.*[20]

Finally, the legislative history suggests that Congress was advised of the need for curative regulations of the type at issue in this case and may have declined, for that very reason, to bar retroactive rules. During the final House hearings in 1945 on six pending bills, two of which generally barred retroactive rules (see H.R. 339, *supra*; H.R. 1117, *supra*), Representative Gwynne questioned Carl McFarland, former member of the Attorney General's Committee and then-Chairman of the ABA committee on administrative law concerning the impact of the pending proposals on retroactive rules:

> McFarland: Now there is another point that seems to be fairly well agreed upon * * * and that is the rules of an agency, before finally going into effect, should be deferred for, say 30 days * * *.
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> * * * * *

[20] In *Addison* v. *Holly Hill Fruit Products, Inc.*, the Court invalidated a rule promulgated by the Administrator of the Department of Labor's Wage and Hour Division, and remanded the case to the district court with instructions to allow the Administrator to promulgate a new rule retrospectively (see 322 U.S. at 619). The Court reasoned that such a disposition was most "consonant with justice," "law," and "logic" (*ibid.*). The Court never doubted that the Administrator had authority to promulgate a retroactive rule "within the authority given him by Congress" (*id.* at 619, 621), and specifically relied on its own precedent upholding curative laws (*id.* at 622).

> Rep. Gwynne: What about the retroactive effect of regulations?
>
> McFarland: That is quite a subject in itself.
>
> Rep. Gwynne: Do these bills provide that the individual is protected against that?
>
> McFarland: Yes; there is provision respecting that in one or two of the bills. In connection with retroactivity, there are various problems. One is the retroactivity of curative regulations.

1945 House Hearings 32, *reprinted in APA Leg. Hist.* 76, 78.

The exchange is significant in several respects. First, it provides further evidence of a common understanding among those involved in the APA's enactment that future legal effectiveness is not equivalent to a prohibition on retroactive rules. While McFarland stated that there was general consensus regarding the propriety of the former, the retroactivity issue was, by contrast, "quite a subject in itself." Second, the discussion confirms that only those two bills that expressly barred retroactive rules, neither of which were ultimately enacted, actually limited retroactive rules. Finally, the discussion provides at least some evidence that members of Congress had been advised that the need for "curative regulations" presented a "problem[]" for any ban on retroactive rules. This suggests the possibility that Congress ultimately rejected a ban at least partly for that very reason.[21]

Likewise relying on cases involving curative laws, even those dissenting from the Court's disposition of the case in *Addison* agreed that there may be occasion when "corrective needs may prompt and vindicate a grant of such authority" (*id.* at 641 (Rutledge, J., dissenting)).

[21] In earlier Senate Hearings, the General Counsel of the Railroad Retirement Board also advised Congress concerning the need for retroactive rules in certain circumstances. See *1941 Senate Hearings* Pt. 2, at 540 (testimony of Lester P. Schoene).

b. The legislative history of Congress's inclusion of the phrase "future effect" in the APA's definition of "rule" is likewise consistent with our reading of the law. It shows that the language was added merely for purposes of clarification and not for the purpose of making any substantive change in the law. Congress, in effect, intended to codify, not depart from, the traditional meaning of an agency "rule."[22] A prohibition on retroactive rules, however, would have been just such a major departure from settled law and agency practice.

The phrase "future effect" first appeared in the language of the bill reported by the House Judiciary Committee in 1946, which both chambers subsequently passed. None of the prior bills had referred to "future effect" in defining "rule." Proposals for legislation had instead invariably defined a "rule" as an agency statement of "general application," consistent with then-recent congressional enactments and the views of prominent commentators. Compare, *e.g.*, S. 674, 77th Cong., 1st Sess. § 102(c) (1941) ("of general application"), *reprinted in 1941 Senate Hearings* Pt. 1, at 3, and H.R. 339, *supra*, § 1 ("of general applicability"), *reprinted in 1945 House Hearings* 139, with Federal Register Act, ch. 417, § 5, 49 Stat. 501 ("general applicability and legal effect") and Fuchs, *Procedure in Administrative Rule-Making*, 52 Harv. L. Rev. 259, 265 (1938) ("[I]t is useful to define rule-making as the issuance of regulations or the making of determinations which are addressed to indicated but unnamed and unspecified persons or situations * * *.").

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[22] See Davis, *supra*, 57 Yale L.J. at 926 ("The traditional meaning of the word 'rule' remains, and is clarified by the specific language of [the APA] * * *. The overall result is that 'rule' still has about the same meaning as it did before the Act, except that the Act clarifies some points that were doubtful."). See note 13, *supra*.

Although the definition of "rule" in pending legislative proposals maintained its focus on "general applicability" through March 1946, when the Senate initially passed the legislation, the Senate did make one change in wording. In response to the concern expressed during House hearings and in agency comments that the requirement of "general applicability" would improperly place certain proceedings—such as rate determinations by the Interstate Commerce Commission—outside the definition of agency "rulemaking," the Senate Judiciary Committee amended the definition of "rulemaking" to include "any prescription for the future of rates, wages, financial structures" (S. Rep. 752, 79th Cong., 1st Sess. 11 (1945), *reprinted in APA Leg. Hist.* 197; see Senate Comm. on the Judiciary, 79th Cong., 1st Sess. (Comm. Print 1945), excerpt *reprinted in APA Leg. Hist.* 14; *1945 House Hearings* 77-80, *reprinted in APA Leg. Hist.* 123-126).

The House Judiciary Committee accepted the language added by the Senate (shifting it, however, to the definition of "rule") and added more language to the same effect, including the requirement of "future effect." In particular, the House Committee modified the definition of "rule" to state that a rule has "general or particular applicability and future effect." H.R. Rep. 1980, 79th Cong., 2d Sess. 2, 19-20, 49 & n.1 (1946), *reprinted in APA Leg. Hist.* 236, 254, 283 & n.1).[23] The accompanying House Report leaves

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[23] The additional words "particular" and "future effect" seem to have had their genesis in two different sources. The House appears to have adopted "particular" from the Senate Report's explanation of its inclusion of specific language designed to bring ratemaking proceedings within the "rulemaking" defintion. See S. Rep. 752, *supra*, at 11, *reprinted in APA Leg. Hist.* 197 (emphasis added) ("The specification of the activities that are involved in rule making is included in order to comprehend them beyond any possible question. They are defined as rules to the extent that, *whether of general or particular applicability*, they formally prescribe a course of conduct for the future rather

no doubt that the words "future effect" pertained to the legal effectiveness of a rule and application in a further proceeding and did not proscribe the imposition of retroactive regulations when otherwise in accordance with law. The Report explains that "[t]he phrase 'future effect' does not preclude agencies from considering, and so far as legally authorized, dealing with past transactions in prescribing rules for the future" (H.R. Rep. 1980, *supra,* at 49 n.1, *reprinted in APA Leg. Hist.* 283 n.1). According to the Report, therefore, a rule may, as in this case, be effective in the "future," yet, once effective, "deal[] with past transactions."

Senate consideration of the bill, as amended and passed by the House, confirms that the legislators did not believe that the new House language barred retroactive rules. The Senate sponsor of the legislation stressed that the Attorney General had concluded that "the amendments which had been made by the House * * * were merely explanatory in nature" (92 Cong. Rec. 5790 (1946) (remarks of Sen. McCarren), *reprinted in APA Leg. Hist.* 422; see H.R. Rep.

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than merely pronounce existing rights or liabilities."). See H.R. Rep. 1980, *supra,* at 49 n.1, *reprinted in APA Leg. Hist.* 283 n.1 ("The change of the language to embrace specifically rules of 'particular' as well as 'general' applicability is necessary in order to avoid controversy and assure coverage of rule making addressed to named persons. The Senate committee report so interprets the provision, and the other changes are likewise in conformity with the Senate committee report (p.11)."). "Future effect," however, may have originated in the Model Administrative Procedure Act adopted in 1944 by the National Conference of Commissioners on Uniform State Laws. See *1944 Handbook* 106-109, 329 (emphasis added) (defines rule as including "every regulation, standard, or statement of policy or interpretation of general application and *future effect* * * *"). At least one member of that Conference Committee (Professor Ralph Fuchs) also served on the Attorney General's Committee. We could find no explanation for the Conference's addition of "future effect." Compare *ibid.* with *1943 Handbook* 226-230, 231.

1980, *supra,* at 57, *reprinted in APA Leg. Hist.* 291 (letter from Attorney General Tom C. Clark)). The sponsor also assured another Senator that the House changes "do not materially affect the intent of the act" (92 Cong. Rec. 5791, *reprinted in APA Leg. Hist.* 423). With that assurance, debate on the changes by the House immediately ended and the bill was passed (*ibid.*).

c. In light of these explicit statements of legislative intent, the court of appeals plainly erred in ruling that "future effect" evinces congressional intent to prohibit retroactive rules. Congress repeatedly declined to do just that in considering proposals for legislation. And, in commenting on the addition of the "future effect" language, the House Report specifically disavowed any intention of doing so.

It is not surprising therefore that the court of appeals' decision is contradicted by the authoritative manual on the APA published by the Attorney General's Committee on Administrative Procedure one year after the statute's enactment. The Committee there concluded that "[n]othing in the Act precludes the issuance of retroactive rules when otherwise legal" (*Attorney General's Manual* 37).[24] The Manual's construction of the APA is entitled to considerable deference. See *Steadman* v. *SEC,* 450 U.S. 91, 103 n.22 (1981); *Chrysler Corp.* v. *Brown,* 441 U.S.

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[24] The Manual adds that the issuance of retroactive rules should also be "accompanied by the finding required by section 4(c)" (*Attorney General's Manual* 37), which is the finding of "good cause" that an agency must make if it wishes to make a substantive rule legally effective less than 30 days from the date of its publication. Neither the language of the APA nor its legislative history supports the Manual's apparent assumption that the good cause finding required for an early effectiveness date automatically applies to the issuance of retroactive rules. Perhaps the Committee was anticipating that certain retroactive rules would also be given early effective dates, in which case a good cause finding would, of course, be required.

281, 302 n.31 (1979); *Vermont Yankee Nuclear Power Corp.* v. *NRDC, Inc.*, 435 U.S. at 546.

C. The Secretary's Retroactive Cost Limit Rule Is not Inconsistent with the Medicare Act

There is likewise no merit to respondents' contention (Br. in Opp. 9-11) that the Medicare Act itself bars the Secretary from promulgating a retroactive cost limit rule in the context of this case. Significantly, respondents can point to no language in the text of the Medicare Act indicating that Congress enacted such a prohibition.[25] Instead, respondents principally rely (Br. in Opp. 9) on the legislative history of Section 223(b) of the Social Security Amendments of 1972, Pub. L. No. 92-603, 86 Stat. 1393, which amended Section 1861(v)(1)(A) to allow the Secretary to promulgate cost limit rules on a presumptive and class-wide basis.[26] In commenting on this change, the House and Senate reports contrast the Secretary's new

[25] The amendatory language relied upon by respondents (42 U.S.C. (& Supp. III) 1395x(v)(1)(A)) provides that regulations "may provide for the establishment of limits on the direct or indirect overall incurred costs or incurred costs of specific items or services or groups of items or services to be recognized as reasonable based on estimates of the costs necessary in the efficient delivery of needed health services to individuals covered by the insurance programs established under this subchapter"). Contrary to respondents' claim (Br. in Opp. 9), the phrase "to be recognized" provides no support for their argument. That reference to a future event simply reflects the commonsense notion that reimbursement determinations, by their very nature, occur after costs have been incurred.

[26] In 1972, Congress also amended the definition of "reasonable cost" to exclude from "cost actually incurred" "any part of incurred cost found to be unnecessary in the efficient delivery of needed health services" (§ 223(a), 86 Stat. 1393 (42 U.S.C. 1395x(v)(1)(A)). The Secretary's new authority to promulgate cost limit rules was in furtherance of this legislative change in the statutory measure of "reasonable cost."

authority to issue cost limit rules with the prior medicare cost reimbursement scheme, under which excessive costs could be disallowed only on a case-by-case basis. The reports state that the new "authority to set limits on costs recognized for certain classes of providers * * * would be exercised on a prospective, rather than retrospective, basis so that the provider would know in advance the limits to Government recognition of incurred costs and have the opportunity to act to avoid having costs that are not reimbursable." H.R. Rep. 92-231, 92d Cong., 1st Sess. 83 (1971); S. Rep. 92-1230, 92d Cong., 2d Sess. 188 (1972).

The validity of the Secretary's 1984 cost limit rule, however, does not depend on the scope of the Secretary's authority to promulgate cost limit rules in the first instance, which is the focus of the statements upon which respondents rely. Rather, its validity turns on the scope of an agency's authority, following judicial invalidation of a wholly prospective cost limit rule because of procedural irregularities, to promulgate a new rule on remand that applies to the same time period that would have been covered by the invalidated rule. Different considerations apply in the context of a judicial remand.[27]

First, invalidation of the agency's prior rule does not eliminate the agency's duty to fulfill its statutory mandate, which, as in this case, may warrant the promulgation of a retroactive rule. For example, where the invalidated rule is the first ever promulgated by the agency to implement a federal program, congressional intent could be wholly undermined if, as respondents argue, the agency were unable to promulgate new rules that apply to the same

[27] For this same reason, respondents' reliance on a series of statements by the Secretary that certain cost limit rules would operate prospectively is equally misplaced (see Br. in Opp. 10-11). Respondents refer to no statement by the Secretary that the Medicare Act bars the issuance of a retroactive cost limit rule following judicial invalidation of the Secretary's prior rule on procedural grounds.

time period. See *Addison* v. *Holly Hill Fruit Products, Inc.*, 322 U.S. at 619-622. The same concerns apply, albeit to a lesser degree, in a case such as this one where the invalidated rule is not the first promulgated following the statute's enactment. Cf. *SEC* v. *Chenery Corp., supra*; *Burlington Northern Inc.* v. *United States, supra* (invalidation of rate order does not "revive" earlier outdated rate order). At stake in this case is fulfillment of Congress's determination that a provider "should not be shielded from the economic consequences of its inefficiency," including excessively high labor costs. See H.R. Rep. 92-231, *supra*, at 83, 84; see also S. Rep. 92-1230, *supra*, at 187, 188. That purpose would be wholly frustrated if procedural irregularities were allowed to immunize providers from cost limit rules designed to root out such inefficiencies.

Moreover, because the substance of the 1984 cost limit rule does not differ from the prospective rule promulgated in 1981 prospectively, the Secretary's curative rulemaking did not interfere with the providers' ability to "know in advance the limits to Government recognition of incurred costs"; nor did it deny the provider "the opportunity to act to avoid having costs that are not reimbursable." H.R. Rep. 92-231, *supra*, at 83; S. Rep. No. 92-1230, *supra*, at 188. The 1981 rules put respondents on notice, before they are incurred, of how wage costs for which they subsequently sought reimbursement under the Medicare Act would be computed. Hence, the concerns expressed in the legislative history are not implicated here and do not support invalidation of the Secretary's 1984 cost limit rule.

D. The Secretary's Decision to Apply His 1984 Cost Limit Rule Retroactively Was not Arbitrary and Capricious

Respondents may also argue that, even if neither the APA nor the Medicare Act specifically prohibits retroactive cost limit rules, the Secretary's 1984 cost limit rule is

invalid because the Secretary's decision to adopt a retroactive rule was itself arbitary and capricious.[28] We, of course, agree that the absence of any prohibition on retroactive rules in either the APA or the Medicare Act does not mean that the Secretary's decision to promulgate a retroactive rule must be upheld in every case. The Secretary's exercise of his general rulemaking authority to adopt a retroactive rule must be set aside if it is "arbitrary, capricious, an abuse of discretion, or otherwise not in accordance with law" (5 U.S.C. 706(2)(A)). Unlike respondents, however, we do not believe that the Secretary's 1984 decision runs afoul of that standard of review.

The touchstone for determining whether an agency's decision to adopt a retroactive rule is arbitrary and capricious is this Court's decision in *SEC* v. *Chenery Corp.*, 332 U.S. 194 (1947), which upheld the retroactive application of a new principle of law in the context of an adjudication. The Court there stated that "such retroactivity must be balanced against the mischief of producing a result which is contrary to a statutory design or to legal or equitable principles. If that mischief is greater than the ill effect of the retroactive application of a new standard, it is not the type of retroactivity which is condemned by law." *Id.* at 203.[29]

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[28] Respondents also suggest (Br. in Opp. 24-25) that the judgment of the court of appeals should be affirmed based on substantive defects in the rule. Because neither the court of appeals nor the district court reached that issue, however, we do not believe this Court should address this contention in the first instance. If the Court agrees that the Secretary was not barred from promulgating retroactive rules and that its decision to adopt such a rule in 1984 was not arbitrary and capricious, the Court should reverse the court of appeals' judgment and remand the case for consideration of any remaining issues that were raised below by respondents.

[29] Of course, the issuance of a retroactive rule must be consistent with the Constitution. The Court has concluded that "[t]he retroactive

The Secretary's decision in 1984 to promulgate a retroactive rule easily satisfies this test. First, the purpose of the retroactive regulation is to avoid a windfall by respondents at the expense of the government: the recovery of approximately $2 million in costs that the Secretary has deemed to be inefficiently incurred, and which, for that reason, should not be reimbursed by Medicare.[30] As we have discussed (pages 15-18, *supra*), respondents have no legitimate claim of entitlement to reimbursement based on their invalidation of the 1981 rule on procedural grounds. The district court's ruling in 1983 entitled them to certain notice and comment procedures should the Secretary decide to reissue the rule, but not to any specific substantive result. In addition, the 1984 retroactive cost limit rule benefited more hospitals than it burdened. See 49 Fed. Reg. 6177 (1984) (retroactive rule "avoids placing an unwarranted hardship and burden on intermediaries and many hospitals, while it would impose only a minimal burden on few hospitals"). The public interest therefore weighs strongly in favor of the retroactive rule to avoid both any undue windfall to respondents and undue burden on other providers.

Second, respondents can claim no reasonable reliance interest because the 1984 retroactive rule is merely curative

aspects of legislation, as well as the prospective aspects, must meet the test of due process, and the justifications for the latter may not suffice for the former." *Usery* v. *Turner Elkhorn Mining Co.*, 428 U.S. 1, 16-17 (1976). That due process standard requires a "showing that the retroactive application of the [regulation] is itself justified by a rational * * * purpose." *Pension Benefit Guaranty Corp.* v. *R.A. Gray & Co.*, 467 U.S. 717, 730 (1984). Respondents, however, have not challenged the constitutionality of the Secretary's 1984 cost limit rule.

[30] For the purpose of considering respondents' claim that the Secretary's decision to apply his 1984 cost limit rule retroactively was arbitrary and capricious, the substance of that rule—which was not questioned by the court of appeals or district court—is presumptively valid. See note 28, *supra*.

in character. "[T]he individual who claims that a vested right has arisen from the defect is seeking a windfall since, had the legislature's or administrator's action had the effect it was intended to and could have had, no such right would have arisen." Hochman, *supra,* 73 Harv. L. Rev. at 705. In this case, respondents incurred all the relevant costs before the 1981 regulation was invalidated by the district court. Consequently, respondents had ample notice that the reasonableness of those costs would be assessed against the standard ultimately contained in the 1984 rule. Certainly there is no reason to believe that respondents would have acted differently but for the nominal retroactivity of the 1984 rule.[31]

Finally, the voluntary nature of the Medicare program, coupled with respondents' longstanding knowledge that "retroactive corrective adjustments" of one form or another were authorized by Section 1861(v)(1)(A)(ii) of the Act,[32] further diminishes the strength of respondents' claims that retroactive application of the 1984 cost limit rule is somehow unfair. " 'When providers joined the [Medicare] program, they knew that "small repairs" in the regulatory scheme were likely;' indeed, the statute warned that they would be reimbursed only for 'reasonable cost' and that retroactive adjustments might be necessary to ensure that no overpayments were made." *Daughters of*

[31] See *Illinois* v. *Bowen,* 786 F.2d 228, 292 (7th Cir. 1986) ("A critical question is how the conduct or practices of the [plaintiff] would have been different if the current interpretation of the regulations had applied from the start."); *Adams Nursing Home of Williamstown, Inc.* v. *Mathews,* 548 F.2d 1077, 1081 (1st Cir. 1977) ("In any retroactivity challenge, a central question is how the challenger's conduct * * * would have differed if the law in issue had applied from the start.").

[32] As discussed at pages 40-47, *infra,* Section 1861(v)(1)(A)(ii) also independently authorizes retroactive application of the Secretary's 1984 cost limit rule.

Miriam Center for the Aged v. *Mathews,* 590 F.2d 1250, 1261 (3d Cir. 1978) (quoting *Adams Nursing Home of Williamstown, Inc.* v. *Mathews,* 548 F.2d 1077, 1081 (1st Cir. 1977)). Indeed, because providers, such as respondents, are equally entitled under the statutory scheme to retroactive *increases* in reimbursement in appropriate circumstances, they are especially hard pressed to complain about unfairness in retroactive *decreases.* See *Fairfax Nursing Center, Inc.* v. *Califano,* 590 F.2d 1297, 1300 (4th Cir. 1979).[33]

II. SECTION 1861(v)(1)(A)(ii) OF THE MEDICARE ACT SPECFICALLY AUTHORIZES THE SECRETARY'S PROMULGATION OF A RETROACTIVE COST LIMIT RULE TO PREVENT EXCESSIVE REIMBURSEMENT

Even if the 1984 retroactive cost limit rule were somehow invalid as an exercise of the Secretary's general rulemaking authority, Section 1861(v)(1)(A)(ii) of the Medicare Act, 42 U.S.C. (Supp. III) 1395x(v)(1)(A) (Clause (ii)), independently authorizes the Secretary to promulgate such a rule.[34]

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[33] The district court reached a contrary conclusion in applying the balancing test set forth in *Retail, Wholesale & Dep't Store Union* v. *NLRB, supra* (Pet. App. 35a-39a). Its analysis is flawed by its failure to recognize that respondents' reliance interest must be assessed as of the time they engaged in the underlying conduct. The court erroneously concluded that respondents had a cognizable reliance interest in retaining the windfall they obtained by virtue of the Secretary's procedural error. The court also erred in finding that the public interest weighed against the application of the revised methodology for calculation of the indices without first finding that that methodology was substantively invalid. If the methodology is valid (which must be assumed (see notes 28, 30, *supra*)), it is, by definition, the proper approach for calculating the reasonable cost. Any award in excess of that amount violates the statute and therefore is contrary to the public interest.

[34] The court of appeals wrongly suggested that the Secretary cannot rely on Clause (ii) as authority for his 1984 rule because he failed to cite to that specific provision or make specific findings under it in promulgating those rules (see Pet. App. 16a). But the Secretary did expressly invoke Section 1861(v)—of which (v)(1)(A)(ii) is a subsection—as authority for the issuance of the 1984 rule. See 49 Fed. Reg. 6180 (1984); *id.* at 46501. Surely the Secretary is not required to list separately every subsection upon which he specifically relies in promulgating a rule. In any event, as noted by this Court in *Massachusetts Trustees of Eastern Gas & Fuel Associates* v. *United States,* 377 U.S. 235, 247-248 (1964), an agency's failure to invoke the correct statutory authority does not require invalidation of the agency's action where "a mistake of the administrative body is one that clearly had no bearing on the procedure used or the substance of the decision reached." See also *NLRB* v. *Wyman-Gordon Co.,* 394 U.S. 759, 767 n.6 (1969); *Illinois* v. *ICC,* 722 F.2d 1341, 1348-1349 (7th Cir. 1983); cf. *Baylor University Medical Center* v. *Heckler,* 758 F.2d 1052, 1060 n.14 (5th Cir. 1985). That principle plainly applies here.

1. Clause (ii) empowers the Secretary of Health and Human Services to issue regulations that "provide for the making of suitable retroactive corrective adjustments where * * * the aggregate reimbursement produced by the methods of determining costs proves to be either inadequate or excessive." There is considerable disagreement among the lower courts regarding the scope of the Secretary's authority under this provision.[35] As the court

[35] Some courts of appeals have concluded that "[u]pon determining that one of his cost reimbursement regulations produces inadequate or excessive reimbursement payments to providers, the Secretary has a statutory duty [under Clause (ii)] to make suitable retroactive corrective adjustments" through the issuance of regulations. *Springdale Convalescent Center* v. *Mathews,* 545 F.2d 943, 954 (5th Cir. 1977). These courts have held that the Secretary may—and in some circumstances must—apply revised cost reimbursement regulations retroactively where the prior rule resulted in an improper level of reimbursement. *Ibid.*; see also Pet. 13-14 (citing cases). The court below took a narrower view of Clause (ii), holding that the provision does not empower the Secretary to issue retroactive rules, but only authorizes retroactive adjustment of reimbursement awards on a case-by-case basis upon proof that a particular reimbursement award was either inadequate or excessive. Pet. App. 16a-19a; see also Pet. 14. A third group of courts

of appeals itself acknowledged (Pet. App. 16a (footnote omitted)), the courts "have struggled to define the precise contours of the retroactive correct adjustments provision."

In the Secretary's view, Clause (ii) authorizes the Secretary to issue a retroactive regulation of general application where, as in this case, the application of a prior cost reimbursement regulation has resulted in systemically excessive or inadequate reimbursement. The validity of the Secretary's construction depends, of course, on its reasonableness. See, *e.g.*, *Young* v. *Community Nutrition Inst.*, 476 U.S. at 980-981; *Chevron U.S.A. Inc.* v. *NRDC, Inc.*, 467 U.S. at 842-844; *Chemical Mfrs. Ass'n* v. *NRDC, Inc.*, 470 U.S. 116, 125 (1985). Where "Congress has not directly addressed the precise question at issue, the court does not simply impose its own construction on the statute, as would be necessary in the absence of an administrative interpretation." *Chevron U.S.A. Inc.* v. *NRDC, Inc.*, 467 U.S. at 842. Rather, the only question is whether the Secretary's understanding of the statute is "sufficiently rational to preclude a court from substituting its judgment for that of the [Secretary]." *Young* v. *Community Nutrition Inst.*, 476 U.S. at 981; see *Chemical Mfrs. Ass'n* v. *NRDC, Inc.*, 470 U.S. at 125. Indeed, even if the "Court of Appeals' reading of the statute may seem to some to be the more natural interpretation," the Secretary's view must be upheld so long as the "phrasing * * * admits" of that reading. See *Young* v. *Community Nutrition Inst.*, 476 U.S. at 980.

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has stated that the provision does not permit any retroactive reassessment of reimbursement decisions, but only directs the Secretary "to promulgate regulations that mandate retroactive adjustments in the *payments* received by providers, so as to bring the amounts paid to them on the basis of their monthly estimates in line with the amount actually due them under the annual audit." *Daughters of Miriam Center for the Aged* v. *Mathews*, 590 F.2d at 1258 n.23 (emphasis in original); see Pet. 14-15.

2. The Secretary's suggested interpretation of Clause (ii) is a reasonable reading of the provision; the language "admits of" the Secretary's construction, that construction is not contradicted by the provision's legislative history, and it represents a sensible attempt to accommodate Congress's purposes and considerations of administrative feasibility.

a. First, contrary to the court of appeals' assertion (Pet. App. 16a-17a), the language does not "plainly" refute the Secretary's view. Clause (ii) does not, as respondents suggest (Br. in Opp. 13 (emphasis omitted)), provide that the Secretary may issue regulations only for the purpose of establishing a "process" for making "case-by-case" adjustments for "particular providers." The words "process," "case-by-case," and "particular providers" do not appear anywhere in Clause (ii). To the contrary, the statute broadly authorizes the Secretary to issue "regulations" that "provide for the making of suitable retroactive corrective adjustments," without limiting the Secretary's methodology for doing so. As applied to this case, the prior (1979) cost limit rule constitutes a "method[] of determining costs" that the Secretary has determined was leading to "excessive" reimbursement. The 1984 cost limit rule is, accordingly, a regulation for the purpose of "making * * * suitable retroactive corrective adjustments."[36]

To be sure, the language of Clause (ii) is clearly broad enough to *permit* the Secretary to decide that retroactive corrective adjustments would best be achieved in certain circumstances through case-by-case adjudications directed

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[36] The reference in Clause (ii) to "a provider of services" is not to the contrary. It simply means that the Secretary must provide for the making of retroactive adjustments for "a" provider, but does not state how the Secretary must do so. In particular, the provision does not state that the Secretary must conduct a separate proceeding for each individual provider.

to particular providers.[37] But, contrary to respondents' claim, the language of Clause (ii) does not adopt case-by-case adjudication as the *exclusive* procedure available to the Secretary in all circumstances. It focuses solely on the "method" that prompted the erroneous reimbursement—which in this case was a cost limit rule—and authorizes the Secretary to promulgate "regulations" to redress that error.[38] "[M]ethods" of reimbursement differ and those differences may properly influence the Secretary's determination of the most suitable manner of making a retroactive corrective adjustment.

Indeed, the sentence in which Clause (ii) appears begins with the phrase "[s]uch regulations." That reference logically includes those "regulations" that the Secretary is authorized to promulgate "for the establishment of limits on * * * incurred costs" (42 U.S.C. (& Supp. III) 1395x(v)(1)(A)). Thus, the literal language of the statute provides that cost limit regulations shall provide for "suitable retroactive corrective adjustments." The fact that Clause (ii) was enacted in 1965, before the cost limit rules were authorized (see page 34, *supra*), does not undermine this point. The Secretary may reasonably construe the meaning of Clause (ii) in accordance with the settled

[37] The Secretary's cost limit regulations do establish an exceptions process through which an individual provider may seek a reclassification, an exemption or exception from cost limits, or an adjustment of inpatient operating costs. See 42 C.F.R. 413.30(d)-(h).

[38] Contrary to the court of appeals' suggestion (Pet. App. 12a n.11), moreover, our construction of Clause (ii) would not allow the Secretary to make his regulations retroactive for an unlimited period of time. Clause (ii) does not override other provisions of the Medicare Act. Thus, when a reimbursement award is final and no longer subject to reopening (see 42 C.F.R. 405.1885), that award cannot be reconsidered pursuant to a rule issued under Clause (ii). See 51 Fed. Reg. 11188 (1986) (stating that retroactive application of medical malpractice cost standard is limited to cost reports not yet closed and cost reports still subject to reopening).

principle of statutory construction that "the provisions introduced by the amendatory act should be read together with the provisions of the original section that were reenacted or left unchanged, in the amendatory act, as if they had been originally enacted as one section." See 1a N. Singer, *Statutes and Statutory Construction* § 22.34, at 293 (4th ed. 1985) (footnotes omitted); see also *id.* § 22.35, at 296.

b. Nor does the legislative history "plainly" or "unambiguously" support the court of appeals' and respondents' narrow reading of Clause (ii), and thus require rejection of the Secretary's own construction. Indeed, respondents and the court of appeals do not cite to any legislative history that discusses the meaning of Clause (ii). They rely instead exclusively on legislative history pertaining to the meaning of Section 223(b) of the Social Security Amendments of 1972, which amended Section 1861(v)(1)(A) to authorize the Secretary to establish cost limit rules for the Medicare program. As previously discussed (page 35, *supra*), the Senate and House reports accompanying that amendment suggest that cost limit rules would generally operate prospectively. That legislative history, however, sheds little, if any, light on the meaning of Clause (ii). The amendment was adopted seven years after Clause (ii) was enacted; it left the language of Clause (ii) intact;[39] and its legislative history never even mentions Clause (ii), let alone discusses the relationship of Clause (ii) to the Secretary's authority to promulgate cost limit rules.[40]

[39] Prior to the 1972 amendments, however, Clause (ii) was contained in Section 1861(v)(1)(B). See 42 U.S.C. (1970 ed.) 1395x(v)(1)(B).

[40] In addition, as we discussed previously (pages 35-36, *supra*), those statements do not in any event have any bearing on the validity of a curative rule, such as the Secretary's 1984 cost limit rule, because it is only nominally retroactive and does not deprive the provider of fair notice.

Most fundamentally, the legislative history nowhere states that Clause (ii)'s reference to "such regulations" should not apply equally to the cost limit rules and, hence, allow for their retroactive correction. In the absence of such legislative history, it is reasonable for the Secretary to conclude, consistently with the statutory language, that Congress determined that retroactive correction of cost limit rules, like other "methods of determining costs," was appropriate where the "aggregate reimbursement produced * * * proves to be either inadequate or excessive."

c. Finally, the Secretary's construction of Clause (ii) should be upheld because here, as in *Young* v. *Community Nutrition Inst.*, 476 U.S. at 982, it is "sensible." Congress in 1972 amended the Medicare Act to redefine "reasonable costs" to exclude costs inefficiently incurred and, to that end, to authorize the Secretary to promulgate class-wide cost limit rules (see pages 4, 34 & note 26, *supra*). Congress described the new limits as "ceilings," the purpose of which was "to prevent Government programs from picking up" unreasonable costs. Moreover, the reimbursement program could be implemented "on a class and presumptive basis." H.R. Rep. 92-231, *supra*, at 84; see also S. Rep. 92-1230, *supra*, at 188, 189.

A scheme for "retroactive corrective adjustments" through rules of general application is a sensible, indeed necessary, complement to these changes, particularly Congress's authorization of class-wide cost limit rules. Errors in such rules are often best redressed by changes in the rules themselves, and only retroactive application of those changes will achieve an "adjustment" in the prior erroneous reimbursement award.

In contrast, the construction of Clause (ii) proffered by respondents and the court of appeals would frustrate Congress's overriding purpose of ensuring that hospitals are reimbursed only for their costs that are necessary "in the efficient delivery of needed health services" (42 U.S.C.

(Supp. III) 1395x(v)(1)(A)). Respondents do not deny that the Secretary can make "retroactive corrective adjustments" where a provider's reimbursement levels were initially established by cost limit rules. Nevertheless, respondents apparently would require the Secretary to make such adjustments by undertaking a separate adjudication for each individual provider in which it would be necessary to prove both the flaws in the old reimbursement methodology and the propriety of the new standard. As the Fifth Circuit has observed, however, "regulation [of Medicare reimbursement] cannot be accomplished on a hospital-by-hospital basis." *City of Austin, Brackenridge Hosp.* v. *Heckler*, 753 F.2d 1307, 1317 (5th Cir. 1985). A retroactive rule is the only workable method of achieving "retroactive corrective adjustments" where, as in this case, the Secretary has determined that a flaw in a prior cost limit rule is systematically leading to "excessive reimbursement" in a broad class of cases.[41]

Unlike respondents, we cannot suppose that Congress, when it amended the Medicare Act in 1972 in an effort to prevent the government from paying for the inefficiences of others, intended to require such a wasteful and duplicative administrative practice. In any event, the Secretary's conclusion that Congress harbored no such intent is "sufficiently rational" to be upheld. See *Young* v. *Community Nutrition Inst., supra.*

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[41] Conversely, where an existing cost limit rule is systematically leading to "inadequate reimbursement," within the meaning of Clause (ii), a retroactive rule may likewise be appropriate. Compare *St. Paul-Ramsey Medical Center* v. *Bowen*, 816 F.2d 417 (8th Cir. 1987). Clearly, however, retroactive rules are authorized by Clause (ii) in either both "inadequate" and "excessive" reimbursement cases, or in neither circumstance.

CONCLUSION

The judgment of the court of appeals should be reversed.

Respectfully submitted.

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* The Solicitor General is disqualified in this case.

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No. 87-1097

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Petitioner,

v.

GEORGETOWN UNIVERSITY HOSPITAL, *et al.*,
Respondents.

On Writ of Certiorari to the United States Court of Appeals for the District of Columbia Circuit

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STATEMENT OF THE QUESTION

Whether the Secretary of Health and Human Services may validly apply a retroactive Medicare cost limit rule to recoup from respondents monies that he previously paid them as a result of a final court judgment.

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BRIEF FOR THE RESPONDENTS

STATUTES AND REGULATIONS INVOLVED

1. 5 U.S.C. § 551(4)—Appendix ("App.") at 1.
2. 5 U.S.C. § 553(b)-(d)—App. at 1-2.
3. 5 U.S.C. § 706—App. at 2-3.
4. 42 U.S.C. § 1395x(v)(1)(A) (Section 1861(v)(1)(A) of the Social Security Act)—App. at 3-4.
5. Pub. L. No. 92-603, § 223(b) (1972)—App. at 4.
6. 42 C.F.R. § 413.9(b)(1)—App. at 4-5.
7. 42 C.F.R. § 413.30(a), (b)(3)--App. at 5.
8. 42 C.F.R. § 413.64(a)(1), (b), (f)—App. at 5-7.

STATEMENT OF THE CASE

1. In 1965, Congress enacted the Medicare statute (title XVIII of the Social Security Act) to furnish health insurance benefits for the elderly. Pub. L. No. 89-97, § 102(a). The statute required that hospitals furnishing services to Medicare beneficiaries be reimbursed their "reasonable cost." [1] 42 U.S.C. §§ 1395f(b), 1395x(v)(1)(A). It mandated that the Secretary's implementing regulations "take into account both direct and indirect costs" so that non-Medicare patients would not subsidize costs properly attributable to Medicare patients and Medicare would not subsidize costs properly attributable to non-Medicare patients. 42 U.S.C. § 1395x(v)(1)(A)(i); *Northwest Hospital, Inc. v. Hospital Service Corp.*, 687 F.2d 985, 991 (7th Cir. 1982). It also mandated that the Secretary's regulations "provide for the making of suitable retroactive corrective adjustments where, for a provider of services for any fiscal period, the aggregate reimbursement produced by the methods of determining costs proves to be either inadequate or excessive" (42 U.S.C. § 1395x(v)(1)(A)(ii))—referred to by the court of appeals below as the "retroactive corrective adjustments provision" (Petition Appendix ("Pet. App.") at 6a n.5).

The Secretary published implementing regulations a year later. 31 Fed. Reg. 14,808 (1966). The regulations stated that the "reasonable cost" reimbursement standard is "intended to meet . . . actual costs, however widely they may vary from one institution to another . . . subject to a limitation if a particular institution's costs are found to be substantially out of line with other institutions in the same area which are similar in size, scope of services, utilization, and other relevant factors." 20 C.F.R. § 405.451(c)(2) (1966), redesignated 42 C.F.R. § 413.9(c)(2). They construed the retroactive corrective adjustments provision as simply requiring a year-end settling of accounts reflecting the difference between the amount to which a provider is entitled after a full audit of its cost report for a particular year and the amount of estimated payments that it received during that year. *See* 20 C.F.R. § 405.454(f) (1966), redesignated 42 C.F.R. § 413.64(f) (App. at 6-7); 20 C.F.R. § 405.451(b)(1) (1966), redesignated 42 C.F.R. § 413.9(b)(1) (App. at 4-5); 20 C.F.R § 405.454(a)(1), (b) (1966), redesignated 42 C.F.R. § 413.64(a)(1), (b) (App. at 5-6).

[1] This suit applies only to fiscal years subject to cost reimbursement principles. In 1983, Congress enacted a new payment system, generally known as the Prospective Payment System (PPS), which pays most hospitals (including respondents) for inpatient hospital services in accordance with pre-determined rates, irrespective of their actual costs. *See Washington Hospital Center v. Bowen*, 795 F.2d 139 (D.C. Cir. 1986).

Over time, Congress concluded that the original payment standard failed to provide proper incentives for efficiency and economy. H.R. Rep. No. 92-231, 92d Cong., 1st Sess. 82-85 (1971), Joint Appendix ("J.A.") at 52-57; S. Rep. No. 92-1230, 92d Cong., 2d Sess. 187-190 (1972), J.A. at 58-63. It was also concerned that the Secretary's authority to disallow costs was too limited. *Id.* Accordingly, it amended the Medicare statute in 1972 to allow the Secretary to establish prospective cost limits. Pub. L. No. 92-603, § 223(b) (App. at 4).

2. In 1974, the Secretary published a regulation to implement the authority to establish Medicare cost limits conferred on him by section 223(b) of the 1972 amendments. 39 Fed. Reg. 20,164. Consistent with the statutory language and the legislative history, the regulation specified that cost limits "will be imposed prospectively. . . ." 20 C.F.R. § 405.460(a) (1974), redesignated 42 C.F.R. § 413.30(a)(2) (App. at 5). Pursuant to that regulation, the Secretary published in 1974 his first schedule of limits applicable to "routine costs." [2] 39 Fed. Reg. 20,168 (1974). He thereafter published an annual schedule of routine cost limits for the next seven years.

The Secretary's schedules attempted to classify hospitals according to a variety of factors, including "economic environment." The original schedule reflected "economic environment" by establishing five groupings based on "per capita income." 39 Fed. Reg. 20,168 (1974). This generally had the effect of giving hospitals located in areas with high per capita

[2] "Routine services" are generally "bed and board" services; they include "regular room, dietary, and nursing services, and minor medical and surgical supplies." 42 C.F.R. § 413.53(b)(2).

income relatively high cost limits and hospitals located in areas with low per capita income relatively low cost limits. Although the Secretary's annual schedules became more sophisticated with time, the Secretary followed this basic approach to measuring "economic environment" for the next four annual schedules (1975-1978). *See* 40 Fed. Reg. 23,623-23,624 (1975); 41 Fed. Reg. 26,994-26,996 (1976); 42 Fed. Reg. 53,676-53,678 (1977); 43 Fed. Reg. 43,561-43,563 (1978).

In 1979, the Secretary repealed the "per capita income" approach and substituted a wage index system based on data from the Bureau of Labor Statistics ("BLS") to gauge "economic environment." 44 Fed. Reg. 31,807-31,808, 31,812-31,813 (1979). Hospitals in areas with high hospital wages received higher wage indexes, and consequently higher cost limits, than those in areas with low hospital wages.[3] The Secretary retained the wage index approach to measure "economic environment" for the 1980 and 1981 schedules. 45 Fed. Reg. 41,875-41,876 (1980); 46 Fed. Reg. 33,642-33,643 (1981).

3. The Secretary promulgated the first seven schedules of routine cost limits in accordance with the mandatory notice and comment procedures of the Administrative Procedure Act ("APA"). Pet. App. at 49a. However, on June 30, 1981, the Secretary published the eighth, and final, annual schedule of routine cost limits (applicable to cost reporting periods begin-

[3] The basis for geographic comparison used for the wage index was the Standard Metropolitan Statistical Area ("SMSA")—recently renamed Metropolitan Statistical Area—which is a "statistical area" defined by the Office of Management and Budget. 44 Fed. Reg. 31,807 (1979). The wage index for a particular SMSA was determined by dividing the average monthly hospital wage in the SMSA by the national average monthly hospital wage. *Id.* Thus, if the average monthly hospital wage was $1,200 for a particular SMSA and the national average was $1,000, the SMSA's wage index would be 1.2. If the labor component of the Secretary's *per diem* limits was $100, the adjusted labor component for a hospital in that SMSA would be $120 ($100 x 1.2).

ning in the period July 1, 1981 through September 30, 1982) without using APA notice and comment procedures.[4] He explained that "good cause" existed for waiving APA procedures because the 1981 schedule simply used more recent data [5] but was otherwise based on "the same methodology" as the 1980 limits, which limits had been duly issued under APA notice and comment procedures. 46 Fed. Reg. 33,640.

Despite this representation, the Secretary, in fact, changed the methodology for determining the 1981 limits in one very significant respect. The Secretary had previously included the wages of *all* hospitals in determining the wage indexes in his schedules. But in the 1981 schedule, he excluded data from federal government hospitals for the first time.[6] 46 Fed. Reg. 33,639 (col. 1) (1981). He characterized the exclusion as a "minor technical change[ ]." *Id.* at 33,638 (col. 1) (1981).

4. The exclusion of federal government hospital data had a detrimental effect on respondents, all of which participated in suits filed in the U.S. District Court for the District of Columbia to invalidate the new rule. In *District of Columbia Hospital Association v. Heckler,* No. 82-2520 (Apr. 29, 1983) ("*DCHA*") (Pet. App. at 49a-66a), the court (*per* Judge Louis Oberdorfer) declared the new rule invalid because of the Secretary's failure to comply with APA public participation procedures. Pet. App. at 65a-66a. Because the hospitals had

[4] The 1981 schedule of routine cost limits was replaced in 1982 by a schedule of limits applicable to inpatient operating costs. 47 Fed. Reg. 43,296 (1982). In 1983, Congress enacted PPS. Since that time, there have been no Medicare cost limits applicable to hospitals.

[5] The 1980 wage index was based on 1978 BLS data (45 Fed. Reg. 41,868 (1980)); the 1981 schedule on 1979 BLS data (46 Fed. Reg. 33,638 (1981)).

[6] There was no advance warning for this change. Indeed, during the prior year, the Secretary had twice taken action to correct inadvertent omissions of government hospital data from his wage indexes. *See* 45 Fed. Reg. 41,872-41,873 (1980); 46 Fed. Reg. 7,456-7,457 (1981). He gave no hint in those notices that he regarded the inclusion of federal government hospital data as undesirable or that he was considering a change to his wage index methodology.

not yet completed the administrative process under 42 U.S.C. § 1395oo,[7] the court did not expressly enjoin the Secretary from applying the 1981 wage index in settling the hospitals' cost reports. *Id.* at 62a-63a. However, the court refused to grant the Secretary's request to stay invalidation of the wage index rule pending issuance by the Secretary in accordance with notice and comment procedures. *Id.* at 60a-61a. Such relief was appropriate only in cases involving "emergency situations or wholesale disruption of critical government programs, and lack of a prior regulatory scheme to operate in place of the invalid regulations." *Id.* at 61a. Here, however, "invalidation of the 1981 wage index and formula would leave in place the formula that was arrived at after proper notice and comment procedures and was used successfully to reimburse providers prior to July 1981." *Id.*

The court instructed the hospitals to file appropriate claims under 42 U.S.C. § 1395oo. *Id.* at 63a. It noted that "the Secretary and [his] delegates administering the claims procedure . . . are, of course, obligated to follow the law as it is finally interpreted by the Court." *Id.* It also noted that if the hospitals failed to receive the requested relief in the section 1395oo administrative appeals process, they could once again seek judicial relief, this time "armed with . . . [the court's] declaration" of invalidation. *Id.* at 64a. The court stated that "[i]f the Secretary wishes to put in place a valid *prospective* wage index, [he] should begin proper notice and comment procedures. . . ." *Id.* (emphasis added).

The district court reached the same result in *St. Cloud Hospital v. Heckler,* No. 83-0223 (D.D.C. May 2, 1983, as amended May 19, 1983). Both decisions became final on September 1, 1983, when the court of appeals granted the Secretary's motion to dismiss his appeals.

5. Consistent with *DCHA,* the Secretary proceeded to settle respondents' cost reports for the years affected by the 1981 schedule (fiscal years beginning after June 30, 1981, but before October 1, 1982) by computing respondents' routine cost

[7] The § 1395oo administrative process is described in *Bethesda Hospital Association v. Bowen,* 108 S. Ct. 1255, 1257 (1988).

limits in accordance with the wage index methodology which *includes* federal government hospital data. However, after purporting to follow APA notice and comment procedures, the Secretary reissued in November 1984, *strictly for purposes of the 1981 schedule of routine cost limits,* the wage index methodology which *excludes* federal government hospital data. 49 Fed. Reg. 6,175 (proposed rule), J.A. at 15-28; 49 Fed. Reg. 46,495 (final rule), J.A. at 29-47. Based on that retroactive rule, the Secretary's agents reopened respondents' already settled 1981 and/or 1982 cost reports to recoup in 1985 the monies previously paid to respondents. The reopening notices stated that the recoupment was "based on a reversal" of the *DCHA* decision effected through the Secretary's retroactive rulemaking. *See, e.g.,* J.A. at 48.

After exhausting administrative remedies, respondents brought suit for a second time to seek the return of the monies previously paid to them as a result of their first court victory. The district court (*per* Judge Oberdorfer) again ruled in the hospitals' favor. Pet. App. at 20a-42a. The court noted that it is not clear that the Secretary is authorized to apply a retroactive cost limit rule, but found resolution of that question "unnecessary." *Id.* at 33a-34a. Based on the five-pronged "balancing" test established in *Retail, Wholesale and Department Store Union, AFL-CIO v. NLRB,* 466 F.2d 380 (D.C. Cir. 1972) for retroactive adjudicative rules, the court held that the particular retroactive rule issued here, which it characterized as "simply *pro forma*" (Pet. App. at 38a), is substantively invalid as applied to the respondents. *Id.* at 34a-39a. It ordered the Secretary to pay the respondents all amounts recouped through the Secretary's retroactive wage index rule.[8] *Id.* at 42a.

The Secretary appealed. His brief accurately describes the ruling of the court of appeals (Pet. App. at 1a-19a). *See* Brief for the Petitioner ("Brief") at 10-12.

[8] The Secretary has complied with the court's order for all but one of the respondents.

SUMMARY OF THE ARGUMENT

I. The Secretary's 1984 wage index rule is a retroactive Medicare *cost limit* rule. It is invalid because the statutory provision authorizing the Secretary to issue cost limit rules (section 223(b) of the Social Security Amendments of 1972) prohibits the Secretary from issuing *retroactive* cost limit rules. The prospectivity requirement of section 223(b) is plainly reflected in the statutory language, the provision's legislative history, the Secretary's cost limit regulation, the Secretary's prior cost limit schedules, and the Secretary's administrative decisions.

The broad construction of the retroactive corrective adjustments provision presented in the Secretary's brief is simply a *post hoc* rationalization of the Secretary's counsel that conflicts with the plain wording of the provision itself and the construction in the Secretary's long-standing regulations. Moreover, even if the broad construction of the Secretary's counsel were generally correct, it would not assist the Secretary here. With respect to Medicare *cost limit* rules, the express prospectivity requirement established by section 223(b) would override the very general retroactive corrective adjustments provision.

II. The Secretary also exceeded his authority under the APA, which defines a rule as "an agency statement of . . . *future effect*" which "includes the approval or prescription *for the future*" of certain matters. 5 U.S.C. § 551(4) (emphasis added). The legislative history of the APA confirms that Congress intended this provision to be construed in accordance with its plain meaning. The Secretary's 1984 retroactive wage index rule does not comply with the APA's definition of a rule because it is devoid of "future effect." It applies solely to cost reporting years beginning in a fifteen month period that closed more than two years before the 1984 rule was even promulgated.

III. It is well-established that the invalidation of a rule that rescinded an earlier rule generally has the effect of reinstating the earlier rule. Although the invalidation of a rule may be stayed in cases of extreme emergency, Judge Oberdorfer found no such emergency in *DCHA*—a decision not appealed by the Secretary.

The legal error found in *DCHA* is one that by its very nature cannot be cured on a retroactive basis. To have validly put into effect his new wage index rule on July 1, 1981, the Secretary would have had to have completed *by June 1, 1981* (thirty days in advance) the four-step prior notice and comment process mandated by the APA. The legal defect found in *DCHA* is that the Secretary tried to put his new rule into effect on July 1, 1981, without first having undertaken any of the required steps. Since the agency had to complete those steps by June 1, 1981, for the rule to be effective July 1, 1981, it is axiomatic that the agency could not cure its prior failure to comply with the APA by undertaking the steps in 1984.

The courts below properly concluded that the Secretary's 1984 retroactive wage index rule seriously compromised the integrity of the administrative process. Acceptance of the Secretary's "curative" rule would reward the Secretary for his 1981 illegal conduct. It would allow him to achieve as a result of the illegal action taken on June 30, 1981, what he could not have achieved if he had acted lawfully on that date (*i.e.*, an effective date for his new rule of July 1, 1981).

The Secretary errs in suggesting that the invalid 1981 rule furnished adequate notice of the standard ultimately adopted in the Secretary's 1984 retroactive rule. The invalid 1981 rule did not furnish the degree of notice which the Secretary had previously recognized as necessary to allow hospitals sufficient time to adjust to lower cost limits. Moreover, respondents were not required to rely on a patently unlawful rule. They were entitled instead to rely on their legal rights, which they vindicated in *DCHA*.

IV. Even assuming *arguendo* the applicability of a balancing test, the balance clearly falls in respondents' favor. On the one hand, the ill effects of the Secretary's retroactive rule were substantial. On the other hand, the rule furthered no statutory interest. In promulgating the rule, the Secretary failed to take into account many relevant factors and drew conclusions clearly contrary to the evidence before him. The effect was to produce a wage index that is considerably less accurate than the one reinstated in *DCHA* and that, as Judge Oberdorfer found, "resulted in under-reimbursement of [respondents'] legitimate costs—which . . . contravene[s] the purposes of the Medicare statutes."

ARGUMENT

I. THE MEDICARE STATUTE PRECLUDES THE SECRETARY FROM ISSUING A RETROACTIVE COST LIMIT RULE.

A. Section 223(b) Of The Social Security Amendments Of 1972 Strictly Limits The Secretary's Authority To The Establishment Of Prospective Cost Limits.

Section 223(b) of the 1972 Social Security Amendments amended section 1861(v)(1)(A) of the Social Security Act, 42 U.S.C. § 1395x(v)(1)(A), to authorize the Secretary to establish limits on hospital costs *"to be recognized* as reasonable. . . ." App. at 4 (emphasis added). The emphasized language plainly requires the Secretary to establish the limits *before* the beginning of the period to which they apply.

The prospectivity requirement of section 223(b) is reflected in its legislative history. In identical language, both the House and Senate reports specify that the cost limits set thereunder must be "exercised on a *prospective, rather than retrospective, basis* so that the provider would know *in advance* the limits to Government recognition of incurred costs and have the opportunity to act to avoid having costs that are not reimbursable." H.R. Rep. No. 92-231, 92d Cong., 1st Sess. 83 (1971), J.A. at 54 (emphasis added); S. Rep. No. 92-1230, 92d Cong., 2d Sess. 188 (1972), J.A. at 60 (emphasis added). Both reports repeat that "the limits would be defined in advance. . . ." H.R. Rep. at 84, J.A. at 54; S. Rep. at 188, J.A. at 60.

The Secretary has consistently recognized that section 223 authorizes only "prospective" limits. His original cost limit regulation expressly stated: "These limits will be imposed *prospectively*. . . ." 20 C.F.R. § 405.460(a) (1974) (emphasis

added), *published at* 39 Fed. Reg. 20,165 (1974).[9] Five years later, the Secretary added the following language:

> *Prior to the beginning of a cost period to which limits will be applied,* the Secretary will publish a notice in the *Federal Register,* establishing cost limits and explaining the basis on which they were calculated.

42 C.F.R. § 405.460 (1979) (emphasis added), *published at* 44 Fed. Reg. 31,804 (1979). The present cost limit regulation retains both of these provisions requiring prospective application. *See* 42 C.F.R. § 413.30(a)(2), (b)(3) (App. at 5).

Significantly, the Secretary purported to publish his 1984 retroactive wage index rule pursuant to the authority in his cost limit regulation (then codified as 42 C.F.R. § 405.460). *See* 49 Fed. Reg. 6,176, 6,180 (1984) (proposed notice), J.A. at 16, 27; 49 Fed. Reg. 46,501 (1984) (final notice), J.A. at 47. *Thus, the Secretary's retroactive cost limit rule was issued pursuant to a cost limit regulation that prohibits retroactive cost limit rules.*

The Secretary's consistent position is also reflected in his previously published cost limits. The preamble of virtually every proposed and final schedule of routine cost limits ever published by the Secretary has specified that section 223(b) allows the imposition of "prospective limits" on the costs reimbursable under Medicare.[10] Ironically, even the 1984 proposed notice for the Secretary's retroactive wage index rule

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[9] The subsection (a) prospectivity language was omitted when the regulation was revised in 1979, but was restored in 1982. The 1982 preamble explains:

> We are amending 42 CFR 405.460(a) . . . by adding a sentence . . . setting forth the general principle . . . that the limits . . . will be applied on a prospective basis. When we revised the regulations . . . [in 1979], reference to the prospectivity of the limits was inadvertently omitted. *We are now inserting language in the regulation to make it clear that the limits are to be applied prospectively.*

47 Fed. Reg. 43,286 (col. 1) (1982) (emphasis added).

[10] *See* 39 Fed. Reg. 10,313 (1974); 39 Fed. Reg. 20,168 (1974); 40 Fed. Reg. 17,190 (1975); 40 Fed. Reg. 23,622 (1975); 41 Fed. Reg. 18,465 (1976); 41 Fed. Reg. 26,992 (1976); 42 Fed. Reg. 40,948 (1977); 42 Fed.

(footnote continues)

accurately stated that section 223(b) authorizes *"prospective* limits." 49 Fed. Reg. 6,176 (1984) (emphasis added), J.A. at 16. Moreover, in prior schedules, the Secretary had specifically pledged that "[*a*]*ny* . . . *changes* [to the cost limits] will be *prospective* in nature" and "will apply to . . . costs *incurred after the effective date of the changes.*" *See* 42 Fed. Reg. 40,948 (1977) (emphasis added); 42 Fed. Reg. 53,675 (1977) (emphasis added).

The Secretary's consistent position is also reflected in his administrative decisionmaking. In *Beth Israel Hospital v. Blue Cross Association,* CCH Medicare and Medicaid Guide ¶ 31,645 (1981), the Secretary (through his delegate, the Deputy Administrator of the Health Care Financing Administration) held that "prospectivity requires" that "[t]he criteria for setting the limits and the limits themselves . . . be established for all categories prior to the cost reporting period." J.A. at 69-70.

Based on a review of the foregoing authorities, the court of appeals very appropriately noted that "we are astonished that the Secretary now purports to have the authority to promulgate [cost limit] rules on a retroactive basis." Pet. App. at 16a. Significantly, the Secretary's final rule (J.A. at 29-47) made no response to respondents' comment that section 223(b) precludes the Secretary from issuing a retroactive cost limit rule. *See* Rulemaking Record ("Rec.") at 143-144.

The Secretary's 1984 retroactive wage index rule significantly reduced respondents' Medicare cost limits, and consequently their Medicare reimbursement, for their *1981* years. A rule that reduces reimbursement for a period that began more than three years prior to its issuance cannot be considered "prospective." [11] Accordingly, the Secretary's retroactive wage

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Reg. 53,675 (1977); 43 Fed. Reg. 43,559 (1978); 44 Fed. Reg. 11,612 (1979); 44 Fed. Reg. 31,806 (1979); 45 Fed. Reg. 21,582 (1980); 45 Fed. Reg. 41,868 (1980); 46 Fed. Reg. 7,456 (1981); 46 Fed. Reg. 33,637 (1981); 46 Fed. Reg. 48,010 (1981).

[11] The Secretary states that respondents "refer to no statement by the Secretary that the Medicare Act bars the issuance of a retroactive cost limit rule following judicial invalidation of the Secretary's prior rule on procedural

(footnote continues)

index rule plainly exceeds the Secretary's authority under section 223(b) and is therefore invalid.[12]

B. The Retroactive Corrective Adjustments Provision Does Not Authorize The Secretary To Issue A Retroactive Cost Limit Rule.

The Secretary's counsel argues that the 1984 retroactive wage index rule was authorized by the retroactive corrective adjustments provision (42 U.S.C. § 1395x(v)(1)(A)(ii)). Brief at 40-47. The Secretary never made any such contention during the rulemaking proceedings.[13] Rather, he stated that he

(footnote continued)

grounds." Brief at 35 n.27. But respondents have pointed to numerous statements by the Secretary categorically requiring prospectivity. Significantly, the Secretary can point to *no* agency statement in the first twelve years after the enactment of § 223(b) stating, or even intimating, that cost limits may be established and applied on a retrospective basis *under any circumstances.*

The Secretary also suggests that the invalid 1981 rule furnished the required prospective notice of the standard ultimately adopted in the 1984 retroactive wage index rule. Brief at 36. However, as discussed at length in § III below, the Secretary's reliance on the invalid 1981 rule is misplaced because (1) invalidation had the effect of depriving the rule of any force; (2) the rule was patently invalid at the time of its publication and respondents were entitled to rely on their right to be bound only by rules published in accordance with lawful procedures; and (3) in any event, the 1981 rule failed to furnish the degree of advance notice which the Secretary had previously recognized as necessary.

[12] Affirmance of the judgment below on this basis would not have broad ramifications. No hospital in the country has been subject to any § 223(b) limits for any costs for any cost reporting year beginning after September 30, 1983. *See* Respondents' Brief in Opposition at 17-18.

[13] The Secretary disputes this. Brief at 40-41 n.34. He relies on a string citation at the end of his 1984 rulemaking notices which includes "section 1861(v)(1)," of which § 1861(v)(1)(A)(ii) (the retroactive corrective adjustments provision) is a part. 49 Fed. Reg. 6,180 (1984), J.A. at 27; 49 Fed. Reg. 46,501 (1984), J.A. at 47. But the Secretary's prior schedules of limits, none of which involved retroactivity, also had this same string citation. *See, e.g.,* 44 Fed. Reg. 31,813 (1979); 45 Fed. Reg. 41,880 (1980); 46 Fed. Reg. 33,645 (1981). The obvious reason is that § 1861(v)(1) includes the language added by § 223(b) of the 1972 Social Security Amendments, which language furnishes the Secretary's sole authorization for the issuance of cost limits.

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was acting pursuant to section 223(b) and purported to justify issuance of a retroactive rule based on unspecified "substantial legal authority" which he apparently believed was applicable to all agencies. *See* 49 Fed. Reg. 6,176 (1984), J.A. at 16; 49 Fed. Reg. 46,497 (1984), J.A. at 36. The Secretary's present contention is, as the court of appeals found (Pet. App. at 16a), nothing more than an impermissible *post hoc* rationalization of the Secretary's counsel. *See Motor Vehicle Manufacturers Association of the United States, Inc. v. State Farm Mutual Automobile Insurance Co.*, 463 U.S. 29, 50 (1983).

The Secretary's belated contention is also quite clearly wrong. With respect to *cost limit* rules, the general retroactive corrective adjustments provision must be construed in light of the more specific language added by section 223(b). Prior to 1972, the Secretary had no authority to issue *any* Medicare *cost limit* rules, prospective or retrospective. The only provision that grants him the authority to issue such rules is section 223(b). Yet, as discussed above in section I.A., section 223(b) clearly prohibits the issuance of retroactive cost limit rules. Obviously, the retroactive corrective adjustments provision could not authorize the Secretary to issue retroactive cost limit rules when the only statutory authority for the issuance of cost limit rules prohibits the Secretary from issuing them retroactively. As the Secretary concedes, the retroactive corrective adjustments provision "does not override other provisions of the Medicare Act." Petition at 17 n.10. Thus, even if the Secretary's broad

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The string citation referred to by the Secretary clearly did not put interested persons on notice that the Secretary believed he was acting pursuant to a special delegation of retroactive rulemaking authority in § 1861(v)(1)(A)(ii). Nor is there the slightest hint in the text of the notices that the Secretary, in fact, held this belief. *See* J.A. at 15-47. Not surprisingly, therefore, none of the interested parties which participated in the rulemaking (including respondents) commented on the retroactive corrective adjustments provision. *See* Rec. at 57-212. Consequently, the Secretary is now precluded from relying on the provision to support his action. *See Global Van Lines, Inc. v. ICC*, 714 F.2d 1290, 1297-1299 (5th Cir. 1983), and the excellent discussion of the legislative history of the APA contained therein.

post hoc construction of the retroactive corrective adjustments provision were correct, it would not change the result here because of the special considerations applicable to section 223(b) rules.[14]

It is clear, however, that the *post hoc* construction of the Secretary's counsel is not correct. The provision does not authorize the Secretary to issue retroactive rules. Instead, it *requires* the Secretary to establish regulations that "provide *for the making of* suitable retroactive corrective adjustments . . . ." App. at 3-4 (emphasis added). In other words, Congress ordered the Secretary to issue a regulation that establishes *a process* for making certain "adjustments." "Adjustments," of course, are normally made to "reimbursement" or payments, not regulations. Moreover, these particular "adjustments" are to be made "where, *for a provider of services for any fiscal period, the aggregate reimbursement* produced by the methods of determining costs *proves to be* either *inadequate or excessive.*" *Id.* at 4 (emphasis added). Accordingly, to make the adjustments properly, the Secretary must determine a *particular provider's* "aggregate reimbursement" for a *particular period* and then determine whether that "aggregate reimbursement" was "inadequate or excessive." *Id.* The Secretary can obviously do that only on a case-by-case basis. Thus, the Secretary's *post hoc* suggestion that this provision authorizes the promulgation of retroactive rules of general applicability for *specific* (not aggregate) costs conflicts with the plain wording of the provision.[15]

[14] If the construction of the Secretary's counsel were correct, the prospectivity requirement in the Secretary's cost limit regulation would be meaningless. In the preceding subsection (§ I.A.), respondents furnished 25 separate citations reflecting the Secretary's view that his authority under § 223(b) is limited to establishing and applying cost limits on a "prospective" basis. Not once did the Secretary suggest that the prospectivity requirement was subject to *any* exceptions.

[15] The Secretary's *post hoc* construction ignores an important difference in scope between § 223(b) and the retroactive corrective adjustments provision. Section 223(b) authorizes the establishment of limits on "overall incurred costs or incurred costs of *specific* items or services" App. at 4 (emphasis added). But the retroactive corrective adjustments provision

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The Secretary has, in fact, *never* published any regulation that has set up a process for issuing retroactive rules. He has, however, published regulations that have set up a process for the making of retroactive adjustments on a case-by-case basis. These regulations, which date from 1966, require the Secretary's agents to make retroactive adjustments for each provider to reconcile the amount to which the provider is entitled after a full audit with the amount of estimated payments received by the provider during the year. *See* 42 C.F.R. § 413.64(a)(1), (b), (f) (App. at 5-7); 42 C.F.R. § 413.9(b)(1) (App. at 4-5).

The Secretary argues in his brief that under *Chevron U.S.A., Inc. v. NRDC, Inc.*, 467 U.S. 837 (1984), the Secretary's construction must be upheld because it is a possible reading of the statutory language. Brief at 14, 42. However, even assuming *arguendo* that the construction presented in the Secretary's brief is a possible reading, the Secretary begs the question of what is properly regarded as the "Secretary's construction." The authoritative source of an agency's construction must surely be its own regulations. Here the Secretary's regulations contradict the construction of the retroactive corrective adjustments provision presented in the Secretary's brief. Significantly, the statement of the "Secretary's view" in his brief is unaccompanied by any citation. *See* Brief at 42. Moreover, the Secretary makes no attempt in his brief to reconcile the "view" presented therein with that presented in his regulations.

(footnote continued)

comes into play only when "*aggregate* reimbursement . . . proves to be either inadequate or excessive." *Id.* at 3-4 (emphasis added).

The Secretary's 1984 retroactive wage index rule applies only to a "specific" item, i.e., wages attributable to "inpatient general routine operating costs." 49 Fed. Reg. 6,176 (1984), J.A. at 17. It does not apply to the cost of special care units or ancillary services or to medical education, capital, or outpatient costs or even to the non-wage component of "inpatient general routine operating costs." 46 Fed. Reg. 33,637 (1981). (According to Georgetown University Hospital's audited Medicare cost report for its fiscal year beginning July 1, 1981, the hospital's total (*i.e.*, wage and non-wage) "inpatient general routine operating costs" accounted for only 36.2% of its "aggregate" Medicare reimbursement.) Thus, the Secretary's reliance on the retroactive corrective adjustments provision must fail because, among other things, there is not the slightest hint that, in promulgating the retroactive wage index rule, the Secretary gave any consideration to "aggregate reimbursement"—a controlling consideration under the plain wording of the retroactive corrective adjustments provision.

The *post hoc* construction of the retroactive corrective adjustments provision presented in the Secretary's brief also conflicts with the construction adopted by the agency near the time of the provision's enactment. In congressional hearings held in 1966, Robert M. Ball, then Commissioner of the Social Security Administration (the agency originally responsible for administering the Medicare program), stated that the provision does not authorize the agency to change reimbursement rules retroactively and, consistent with the regulations issued shortly thereafter, construed the provision as simply requiring a year-end reconciliation based on the results of a final audit.[16] *See Daughters of Miriam Hospital Center for the Aged v. Mathews*, 590 F.2d 1250, 1258-1259 n.23 (3d Cir. 1978). An agency's

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[16] Commissioner Ball testified:

> Payments [to Medicare providers] will be made for services throughout the year and final settlement on a retroactive basis will be made at the end of the accounting period. Continuing payments will be made as often as possible and in no event less frequently than once a month. The retroactive payments will take fully into account costs as they were actually incurred, *determined according to the agreed upon principles of reimbursement—we don't retroactively change the principles*—and settlement will be on an incurred rather than on an estimated basis.

Reimbursement Guidelines for Medicare, Hearings Before the Senate Committee on Finance, 89th Cong., 2d Sess. 56 (1966) (emphasis added).

> *I don't think that the retroactive provision contemplates going back over the year and changing the principles.*
>
> * * * *
>
> [Y]ou make an estimate at the beginning of the year on the basis of these principles. Then at the end of the year you settle up, on the basis of the principles put out.
>
> It would hardly seem reasonable at the end of the year, after hospitals had entered into an agreement with you on the basis of certain principles, to shift all the principles for retroactive settlement in terms of how you compute a cost. *I don't think that was contemplated at all.*

Id. at 119 (emphasis added).

contemporaneous construction is, of course, entitled to considerable deference.[17] *General Electric Co. v. Gilbert,* 429 U.S. 125, 141-142 (1976).

The Secretary's *post hoc* construction also conflicts with the legislative history accompanying the enactment of section 223(b). Both the House and Senate reports expressly state that "present law generally limits exercise of the authority to disallow costs to instances that can be specifically proved on a *case-by-case basis.*" [18] H.R. Rep. No. 92-231 at 83, J.A. at 53; S. Rep. No. 92-1230 at 188, J.A. at 59. Thus, Congress obviously did not believe in 1972 that the retroactive corrective adjustments provision granted the Secretary broad authority to disallow costs through the issuance of retroactive rules of general applicability.[19]

This Court has not looked kindly upon the *post hoc* rationalizations of agency counsel in general. *See Motor Vehicle Manufacturers Association,* 463 U.S. at 50; *Burlington*

[17] In *Heckler v. Community Health Services of Crawford County, Inc.,* 467 U.S. 51, 53-54 (1984), this Court adopted the same construction of the retroactive corrective adjustments provision contained in the Secretary's regulations and reflected in Commissioner Ball's congressional testimony:

> Providers receive interim payments at least monthly covering the cost of services they have rendered. [42 U.S.C.] § 1395g(a). Congress recognized, however, that these interim payments would not always correctly reflect the amount of reimbursable costs, and accordingly instructed the Secretary to develop mechanisms for making appropriate retroactive adjustments when reimbursement is found to be inadequate or excessive. § 1395x(v)(1)(A)(ii).

[18] The Secretary's discussion of the legislative history is contradictory. On the one hand, he alleges that the legislative history "never even mentions Clause (ii), let alone discusses the relationship of Clause (ii) to the Secretary's authority to promulgate cost limit rules." Brief at 45 (footnote omitted). But elsewhere he concedes that "the House and Senate reports contrast the Secretary's new authority to issue cost limit rules with the prior medicare cost reimbursement scheme, under which excessive costs *could be disallowed only on a case-by-case basis.*" *Id.* at 34-35 (emphasis added).

[19] There is no discussion of the retroactive corrective adjustments provision in the 1965 legislative history. This is in itself revealing. It seems certain that the legislative history would have discussed the provision at some length if Congress had intended to delegate to the Secretary special authority to promulgate retroactive rules.

Truck Lines, Inc. v. United States, 371 U.S. 156, 168 (1962). There is even less reason to do so when, as here, the *post hoc* construction conflicts with the plain wording of the statute, the legislative history, the agency's own regulations, and the agency's prior representations to Congress.[20]

II. THE ADMINISTRATIVE PROCEDURE ACT GENERALLY BARS THE SECRETARY FROM ISSUING A RULE, LIKE THE 1984 RETROACTIVE WAGE INDEX RULE, WHICH HAS "PRIMARY" RETROACTIVE EFFECT.

In discussing retroactivity, it is important to distinguish between two different types—"primary" and "secondary." *See* McNulty, *Corporations and the Intertemporal Conflict of Law,* 55 Calif. L. Rev. 12, 57-61 (1967). A rule involves primary retroactivity if it alters the legal consequences of past events *as of the date the events occurred.* An example of primary retroactivity is a rule issued on January 1, 1988, that makes unlawful an act that occurred in 1986. A rule involves secondary retroactivity if it operates prospectively, but affects, as of the date of its adoption, the future legal consequences of an earlier action. An example of secondary retroactivity is a rule issued on January 1, 1988, which affects the future legal consequences of an ongoing activity commenced in 1982, but not completed until 1992. Many rules have some secondary retroactive effect, but primary retroactivity is rare.[21]

[20] There is also merit to the court of appeals' view that "just as substantive legislation will not be given retroactive effect 'unless such be 'the unequivocal and inflexible import of the statutory terms, and the manifest intention of the legislature,'' an organic statute will not be read to authorize an agency to engage in retroactive rulemaking unless it is clear from the terms of the statute that Congress intended such an unusual delegation of power." Pet. App. at 14a-15a (footnote omitted). As this Court has stated, "[t]he power [of an agency] to require readjustments for the past is drastic. . . . [I]t ought not to be extended so as to permit unreasonably harsh action *without very plain words.*" *Brimstone Railroad and Canal Co. v. United States,* 276 U.S. 104, 122 (1928) (emphasis added).

[21] Prior to 1986, many individuals purchased capital assets in the expectation that any gain realized on the sale of such assets would be taxed at a capital gains tax rate. By repealing the capital gains tax rate, the Tax

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The APA clearly establishes a general rule against the promulgation of rules having *primary* retroactive effect.[22] It defines a rule as "an agency statement of . . . *future effect*" which "includes the approval or prescription *for the future*" of certain matters. 5 U.S.C. § 551(4) (emphasis added), App. at 1.[23] Statements of the legislation's sponsors [24] and passages from the *Attorney General's Manual on the APA*[25] confirm that Congress meant exactly what it said. So does a decision of this Court issued one year after the APA was enacted. *See SEC v.*

(footnote continued)

Reform Act of 1986 defeated that expectation *for the future*, thereby having a secondary retroactive effect. The 1986 Act would have had a primary retroactive effect if it had repealed the capital gains tax effective as of 1982 and mandated the reassessment of taxes for 1982-1985 tax years.

[22] Respondents do not contend that there can *never* be exceptions to this general rule. Extraordinary circumstances may arise where even primary retroactivity is unavoidable. For instance, some retroactivity may be necessary where an agency altogether fails to issue regulations to implement a *new* program by the date mandated by Congress. However, as Judge Oberdorfer ruled in another case involving the Secretary, in such circumstances special care must be taken so that interested parties are not unduly harmed by the retroactivity necessitated by the agency's failure to comply with Congress' commands. *See National Association of Rehabilitation Facilities, Inc. v. Schweiker*, 567 F. Supp. 47, 51-53 (D.D.C. 1983).

[23] The Secretary argues that the APA definition simply means that "any application or enforcement will occur *only in the future, i.e.*, in an adjudication." Petition at 19 (original emphasis). Aside from conflicting with the plain wording of the statutory provision (which uses the words "for the future," not "in the future"), the Secretary's construction is contradicted by what happened here. The Secretary enforced his 1984 retroactive wage index rule without the benefit of "an adjudication"; he simply recouped from the respondents' Medicare payments the amounts previously paid under *DCHA*.

[24] *See* Proceedings from the Congressional Record, *Legislative History of the Administrative Procedure Act, 1944-1946*, at 355 ("In rule making an agency is not telling someone what his rights or liabilities are for past conduct or present status under existing law. Instead, in rule making the agency is prescribing what *the future law shall be* so far as it is authorized so to act." (emphasis added)) (remarks of Congressman Francis E. Walter); *id.* at 374 ("[The bill] requires that . . . rules or regulations which have the effect of law must . . . go into effect at some future date.") (remarks of Congressman John W. Gwynne).

[25] *See* Justice Department, *Attorney General's Manual on the Administrative Procedure Act* 13 (1947) ("Of particular importance is the fact that

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Chenery Corp., 332 U.S. 194, 202 (1947) ("Since the Commission, unlike a court, does have *the ability to make new law prospectively through the exercise of its rule-making powers,* it has less reason to rely upon ad hoc adjudication to formulate new standards of conduct. . . . The function of filling in the interstices of the Act should be performed, as much as possible, through this *quasi-legislative promulgation of rules to be applied in the future.*" (emphasis added)).

The Secretary relies on a passage from the report of the House Judiciary Committee which states that "[t]he phrase 'future effect' does not preclude agencies from considering and, so far as legally authorized, dealing with past transactions in prescribing rules for the future." Brief at 32. However, that passage supports respondents, not the Secretary. "[D]ealing with past transactions in prescribing rules *for the future*" is different from prescribing rules for the past. (Emphasis added.) It is *primary* retroactivity, not secondary retroactivity, that is involved in this case and that is generally prohibited by the APA.

The Secretary also relies on the following passage in the *Attorney General's Manual on the APA:* "Nothing in the Act precludes the issuance of retroactive rules when otherwise legal and accompanied by the finding [of good cause] required by [5 U.S.C. § 553(d)]. H.R. REP. p. 49, fn.1 (Sen. Doc. p. 283)." *Manual* at 37. However, that passage expressly cites as authority the passage from the House Judiciary Committee

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'rule' includes agency statements not only of general applicability but also those of particular applicability applied either to a class or to a single person. In either case, they must be of *future effect,* implementing or prescribing future law." (original emphasis)); *id.* at 14 ("Rule making is agency action which *regulates the future conduct* of either groups of persons or a single person; it is essentially legislative in nature, not only because it operates in the future but also because it is primarily concerned with policy considerations. The object of the rule making proceeding is the implementation or prescription of law or policy *for the future, rather than the evaluation of a respondent's past conduct.*" (emphasis added)); *id.* at 128 ("[5 U.S.C. § 553(d)] is not intended to hamper the agencies in cases in which there is good cause for putting a rule into effect immediately, or at some time earlier than thirty days.").

report examined in the preceding paragraph of this brief. Thus, the Attorney General was simply using the term "retroactive rules" loosely to describe rules that deal with past transactions in prescribing standards for the future, *i.e.,* rules involving *secondary* retoractivity. This is confirmed by other passages in the *Manual* that clearly reflect that the Attorney General did not believe that the APA allows an agency to prescribe rules for the past, *i.e.,* rules involving *primary* retroactivity. *See* note 25 above. The passage cited by the Secretary does not, in any event, help the Secretary here because the 1984 retroactive wage index rule was not accompanied by a "good cause" finding (*see* 49 Fed. Reg. 46,495-46,501 (1984), J.A. at 29-47) and, as the court of appeals expressly found, does not come "within any conceivable 'good cause' exception" (Pet. App. at 12a n.11).[26]

The 1984 retroactive wage index rule is totally devoid of "future effect." It applies solely to cost reporting years beginning in a fifteen month period that closed more than two years before the 1984 rule was even promulgated. Accordingly, by promulgating the 1984 retroactive wage index rule, the Secretary exceeded the scope of his rulemaking authority under the APA.[27]

III. THE SECRETARY'S "CURATIVE RULEMAKING" DEFENSE IS UNSUPPORTED BY LAW AND AN AFFRONT TO THE INTEGRITY OF THE ADMINISTRATIVE PROCESS.

1.a. As the *DCHA* court noted (Pet. App. at 63a), the APA provides that a "reviewing court *shall* . . . hold unlawful and *set aside* agency action . . . found to be . . . without observance of procedure required by law." 5 U.S.C. § 706(2)(D)

[26] 5 U.S.C. § 553(d)(3) allows an exception to the normal thirty day delayed effective date requirement "for good cause found and published with the rule." App. at 2. However, the plain wording of the exception only allows an agency to make a rule effective immediately or in less than thirty days, not retroactively.

[27] The APA and § 223(b) furnish *alternative* grounds for invalidating the Secretary's rule; either is sufficient by itself for invalidation.

(emphasis added) (App. at 2). To "set aside" or "vacate" is to " 'annul; . . . cancel or rescind; . . . declare, . . . make, or . . . render, void; . . . defeat; . . . deprive of force; . . . make of no authority or validity. . . .' " *See Action on Smoking and Health v. CAB,* 713 F.2d 795, 797 (D.C. Cir. 1983). Since invalidation deprives a rule of any force, it follows logically that the usual effect of invalidating a rule that purports to repeal an earlier rule is to leave in place the earlier rule.

The lower courts' conclusion here that the invalidation of a rule generally has this effect (Pet. App. at 13a, 32a) is in accord with the holdings of this Court and other courts of appeals. *See, e.g., United States v. Baltimore and Ohio Railroad Company,* 284 U.S. 195, 203-204 (1931); *Mason General Hospital v. Secretary of Department of Health and Human Services,* 809 F.2d 1220, 1223, 1229 (6th Cir. 1987); *Tallahassee Memorial Regional Medical Center v. Bowen,* 815 F.2d 1435, 1453 n.35, 1455-1456 (11th Cir. 1987), *cert. denied,* 108 S.Ct. 1573 (1988); *Abington Memorial Hospital v. Heckler,* 750 F.2d 242, 244 (3d Cir. 1984), *cert. denied,* 474 U.S. 863 (1985); *Lloyd Noland Hospital and Clinic v. Heckler,* 762 F.2d 1561, 1569 (11th Cir. 1985); *Menorah Medical Center v. Heckler,* 768 F.2d 292, 297 (8th Cir. 1985); *Cumberland Medical Center v. Secretary of Health and Human Services,* 781 F.2d 536, 538-539 (6th Cir. 1986); *DeSoto General Hospital v. Heckler,* 766 F.2d 182, 186, *modified on rehearing,* 766 F.2d 186, *original opinion reinstated on rehearing of rehearing,* 776 F.2d 115, 116 (5th Cir. 1985). This general rule has been applied in numerous instances in which the invalidation was based on an agency's failure to comply with the notice and comment procedures of the APA. *See, e.g., Action on Smoking and Health,* 713 F.2d at 797; *W.C. v. Bowen,* 807 F.2d 1502, 1505-1506, *as corrected at,* 819 F.2d 237, 238 (9th Cir. 1987); *Natural Resources Defense Council, Inc. v. U.S. EPA,* 683 F.2d 752, 767-769 (3d Cir. 1982); *Levesque v. Block,* 723 F.2d 175, 187-189 (1st Cir. 1983); *Brown Express, Inc. v. United States,* 607 F.2d 695, 703 (5th Cir. 1979).

Exceptions to this general rule may be appropriate in rare cases. As Judge Oberdorfer noted in *DCHA,* courts have sometimes exercised their equitable powers to stay invalidation

in cases of extreme emergency. Pet. App. at 61a. However, Judge Oberdorfer found no such emergency in *DCHA* and specifically refused to grant the Secretary's request for a stay of invalidation. *Id.* If the Secretary was dissatisfied with that determination, he should have appealed and requested a stay of Judge Oberdorfer's *DCHA* decision.

Although the Secretary contends that invalidation of the 1981 wage index rule did not restore the preexisting wage index methodology, his contention is contradicted by his own actions. Following *DCHA,* the Secretary, in fact, settled respondents' Medicare cost reports in accordance with the preexisting wage index methodology. Pet. App. at 13a, 32a. Moreover, his 1985 reopening notices stated that the reopenings were "based on a reversal" of *DCHA* effected through the Secretary's retroactive rule. *See, e.g.,* J.A. at 48.

It should be noted that the remedy applied here was quite narrow. Invalidation of the 1981 wage index rule did not exempt respondents from the Secretary's cost limits. It simply meant that the Secretary's preexisting wage index methodology (which included federal government hospital data) had to be used in determining the amount of respondents' limits. Respondents have not challenged the Secretary's disallowances to the extent that they resulted from the application of the cost limits as computed under that methodology.

Nor was the Secretary necessarily precluded from disallowing costs that were below the cost limits. The Secretary was still able to disallow a particular hospital's costs to the extent that he found them to be "substantially out of line with [the costs of] other institutions in the same area that are similar in size, scope of services, utilization, and other relevant factors." 42 C.F.R. § 413.9(c)(2), formerly 20 C.F.R. § 405.451(c)(2) (1966); *Memorial Hospital/Adair County Health Center, Inc. v. Bowen,* 829 F.2d 111 (D.C. Cir. 1987). But the Secretary settled all of respondents' cost reports without making any such determination.

The remedy applied here simply gave effect to what the Secretary purported to be doing in issuing the 1981 schedule. The Secretary stated in his 1981 notice that a Regulatory Impact Analysis was not required because "this notice merely

updates economic factors employed in the *existing methodology and does not modify the methodology used to compute the limits in any manner."* 46 Fed. Reg. 33,640 (col. 2) (1981) (emphasis added). Moreover, he found "good cause" for dispensing with notice and comment procedures because the agency developed the limits "by using *the same methodology* . . . used to develop the current [1980] hospital limits."[28] *Id.* (emphasis added). The remedy applied by the courts below does what the Secretary said he was doing; it uses "the same methodology" used for the 1980 limits.

b. The Secretary contends that respondents' "argument is identical to the argument that this Court rejected in *Chenery.*" Brief at 16 n.7. There are, in fact, several very significant distinctions between this case and *Chenery.*

First, *Chenery* involved adjudication, not APA rulemaking—a distinction which, as discussed in section II above, the *Chenery* Court was very careful to draw. 332 U.S. at 202. Indeed, the Court specifically noted that if the agency had proceeded by legislative rulemaking, "the issue . . . would have been entirely different. . . ." *Id.* at 201.

Adjudication, unlike rulemaking, is by its very nature retroactive. By its initial 1941 decision in *Chenery,* the SEC sought to establish, as it was entitled to do, adjudicative rules (or, in APA terminology, "orders" (5 U.S.C. § 551(6)-(7)) applicable to earlier conduct occurring in the period 1937-1940. Following this Court's 1943 remand, the SEC issued a second decision in 1945 which properly explicated the basis of its 1941 decision. By upholding that second decision, the Court did not allow the SEC to do retroactively what otherwise it would have been required by law to do prospectively. Even if the SEC had adequately explained the basis of its decision in 1941, the SEC's decision would have been retroactive—and, because the agency was exercising an *adjudicative* function, properly so. Here, however, because the Secretary was exercising a *legislative* function and doing so in the context of Medicare *cost limit* rules,

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[28] The Secretary did not mention the exclusion of federal government hospital data in either his Regulatory Impact Analysis statement or his "good cause" statement. The only reference to the exclusion is found in a short three-sentence paragraph earlier in the notice. *See* 46 Fed. Reg. 33,639 (col. 1) (1981).

retroactivity was improper *ab initio.* Indeed, as discussed in sections I and II above, two discrete statutory provisions bar the retroactive promulgation and application of Medicare cost limit rules. No such statutory bars faced the SEC in *Chenery.*

Second, in *Chenery,* there was no preexisting rule to fall back on. The SEC "had not previously been confronted with the problem of management trading during reorganization. . . ." 332 U.S. at 203; *see* K. Davis, *Administrative Law Treatise* § 17.09 (1958) ("It is retroactive change in settled law, not retroactive clarification of uncertain law, that may be unfair, and the law or policy that the SEC was changing or developing [in *Chenery*] was highly uncertain, not settled."). Retroactivity was unavoidable because "[e]very case *of first impression* has a retroactive effect, whether the new principle is announced by a court or by an administrative agency." 332 U.S. at 203 (emphasis added). Thus, invalidation of the first agency decision in *Chenery* left a void that needed to be filled.[29] Here, in contrast, "invalidation of the 1981 wage index and formula would leave in place the formula that was arrived at after proper notice and comment procedures and was used successfully to reimburse providers prior to July 1981." *DCHA,* Pet. App. at 61a.

Third, in its first *Chenery* decision, the SEC did not violate any statutory requirements. It simply failed to furnish an explanation of its decision adequate to allow for meaningful judicial review. 332 U.S. at 196-197. Remanding for a further explanation did not place the agency in a better position than it would have been in if it had provided an adequate explanation in its original decision. Here, in contrast, the Secretary's 1981 action violated the express requirements of the APA. Moreover, as will be discussed at length below, upholding the

[29] This was also true in *Addison v. Holly Hill Fruit Products, Inc.,* 332 U.S. 607 (1944), the other case on which the Secretary principally relies. Brief at 16, 28 n.20. In *Addison,* the Court stated that "law should avoid retroactivity as much as possible," but nonetheless allowed retroactive rulemaking because "other possible dispositions likewise involve retroactivity, with the added mischief of producing a result contrary to the statutory design." 332 U.S. at 620; *see also* K. Davis, *Administrative Law Treatise* § 7:23 at 110 (1979) ("The problem [in *Addison*] was not whether to make law retroactively but what law to make retroactively. . . .").

Secretary's 1984 retroactive wage index rule would reward the Secretary for his illegal conduct. It would allow him to achieve as a result of the illegal action taken on June 30, 1981, what he could not have achieved if he had acted lawfully on that date.

Finally, this Court's first *Chenery* decision expressly remanded the case to the SEC for further action. *See SEC v. Chenery Corp.,* 318 U.S. 80, 95 (1943). But Judge Oberdorfer did not "remand" to the agency in *DCHA;* the word "remand" will not be found anywhere in his judgment or opinion. Instead, he issued declaratory relief, noting that, in processing respondents' specific claims, "the Secretary and [his] delegates . . . are, of course, obligated to follow the law as it is finally interpreted by the Court." Pet. App. at 63a. Nothing in his opinion or judgment (which was not appealed by the Secretary) furnishes any authorization for retroactive rulemaking. To the contrary, Judge Oberdorfer's opinion specifies that "[i]f the Secretary wishes to put in place a valid *prospective* wage index, [he] should begin proper notice and comment proceedings. . . ." *Id.* at 64a (emphasis added).

2.a. The Secretary argues that by following APA notice and comment procedures in 1984, he "*corrected* the legal error" found in *DCHA.* Brief at 20 (original emphasis). But that "legal error" is one that by its very nature cannot be corrected retroactively.

Under the APA, an agency must normally follow four steps to effect a substantive change in policy as of a certain date. Specifically, it must publish a notice of the proposed rule; allow interested persons an opportunity to participate; consider relevant comments and materials furnished by the public; and publish the final rule accompanied by a statement of the rule's basis and purpose. 5 U.S.C. § 553(b)-(c) (App. at 1-2). If the agency fails to complete these procedures within thirty days of the desired effective date, it is normally precluded from making a new rule effective on that date.[30] 5 U.S.C. § 553(d) (App. at

[30] "Good cause" exceptions are available in very limited circumstances. *See* 5 U.S.C. § 553(b)(B), (d)(3). However, *DCHA* held that the Secretary had failed to show "good cause" for waiving the normal procedures, a holding not appealed by the Secretary. Pet. App. at 58a-60a.

2). It can make the change in policy effective thirty days after it has completed the required prerequisites, but it cannot make the change retroactive to the date that it originally intended. *See United States v. Gavrilovic,* 551 F.2d 1099, 1103-1105 (8th Cir. 1977); *Rowell v. Andrus,* 631 F.2d 699, 702-704 (10th Cir. 1980); *Ngou v. Schweiker,* 535 F. Supp. 1214, 1216-1217 (D.D.C. 1982).

The "legal error" found in *DCHA* was that the agency failed to undertake before July 1, 1981, any of the four steps which it had to complete before that date in order to make its new wage index rule effective on that date. Since the agency had to complete those steps by June 1, 1981 (thirty days in advance) for the rule to be effective on July 1, 1981, it is axiomatic that the agency could not cure the "legal error" by undertaking the steps in 1984.

The Secretary complains that the lower courts allowed respondents to convert a "procedural victory into a substantive victory." [31] Brief at 18. However, the same complaint could be made by any party that failed to meet a filing deadline or a statute of limitations. For instance, under the Medicare statute (42 U.S.C. 1395oo(f)(1)), a hospital dissatisfied with a final agency reimbursement decision must file a court suit within sixty days. Should a hospital that waited until the seventieth day be heard to argue that the late filing must be given retroactive effect to prevent the Secretary from converting a "procedural" victory into a "substantive" victory? Obviously, if the hospital failed to meet the deadline set by Congress, the Secretary is entitled to his victory, whether it be characterized as "procedural" or "substantive." Properly analyzed, the instant case involves not an attempt by the respondents to convert a procedural victory into a substantive victory, but an attempt by the Secretary to convert a defeat (in the form of a final adverse court judgment) into a victory.

[31] By failing to comply with the notice and comment procedures of the APA, the agency made it impossible for respondents to challenge the 1981 wage index rule on substantive grounds in *DCHA*. A substantive challenge must be based on the rulemaking record. *See Walter O. Boswell Memorial Hospital v. Heckler,* 749 F.2d 788, 792-794 (D.C. Cir. 1984). But there is no rulemaking record where the agency has dispensed with notice and comment procedures.

The Secretary appears to equate "procedural" with "insignificant." But certainly in the case of APA notice and comment procedures, that is not a fair equation. As this Court has recognized specifically with respect to these procedures, "agency discretion is limited not only by substantive, statutory grants of authority, but also by the procedural requirements which 'assure fairness and mature consideration of rules of general application.'" *Chrysler Corp. v. Brown,* 441 U.S. 281, 303 (1979) (quoting *NLRB v. Wyman-Gordon Co.,* 394 U.S. 759, 764 (1969)). Indeed, "[g]iven the lack of supervision over agency decisionmaking that can result from judicial deference and congressional inattention, . . . [APA notice and comment procedures], as a practical matter, may constitute an affected party's only defense mechanism." *Chamber of Commerce of United States v. OSHA,* 636 F.2d 464, 470 (D.C. Cir. 1980). *Accord, Natural Resources Defense Council, Inc. v. U.S. EPA,* 824 F.2d 1258, 1286 (1st Cir. 1987) ("since a reviewing court normally gives deference to the Agency's substantive conclusions in complex regulatory matters, we will insist that the required procedures be strictly complied with."). A court that defers to an agency's substantive decision can at least have some confidence that the decision is fair if the agency followed fair and lawful procedures in reaching the decision.

b. The courts below were properly concerned about the integrity of the administrative process. Judge Oberdorfer concluded that the procedure followed by the Secretary had "trivialized the APA" and that "the ill effects of the Secretary's action are substantial for these plaintiffs and for the general integrity of the administrative rule-making process." Pet. App. at 37a, 38a. The court of appeals agreed, stating that acceptance of the Secretary's position would "make a mockery of the provisions of the APA" and noting that "agencies would be free to violate the rulemaking requirements of the APA with impunity if, upon invalidation of a rule, they were free to 'reissue' that rule on a retroactive basis." *Id.* at 14a; *see also Mason General Hospital,* 809 F.2d at 1231 ("in the context of administrative rulemaking, [retroactivity] trivializes the procedures mandated by the Administrative Procedure Act.").

A simple hypothetical demonstrates the validity of their conclusions. Suppose that each of three agencies decided in June 1981 that it wanted to change one of its rules. Although Agencies *A* and *B* wanted to do so immediately, they realized they could not do so consistently with the APA. Accordingly, they both proceeded to prepare and publish a notice of proposed rulemaking. After analyzing the public comments, Agency *A* decided there was merit to its proposed rule; it published the rule in final on September 1, 1982,[32] and, consistent with 5 U.S.C. § 553(d), made the rule effective October 1, 1982. On the other hand, Agency *B* was persuaded by the public comments that its proposed rule was unwise, causing it to abandon its original plans altogether.

Like Agencies *A* and *B*, Agency *C* also wanted to change its rule immediately, but, unlike the other agencies, it decided to dispense with notice and comment procedures. It published the new rule in final form on June 30, 1981, to be effective the following day. The rule was subsequently invalidated because of Agency *C*'s failure to follow notice and comment procedures, but in 1984, Agency *C* republished the rule, after following notice and comment procedures, and once again made the rule effective July 1, 1981. Agency *C*, of course, followed the exact course of the Secretary in this case.

Should Agency *C* be allowed to make its 1984 rule effective July 1, 1981? If so, Agency *C* has been rewarded for violating the notice and comment procedures mandated by Congress. As a result of its original illegal action, Agency *C* has been able to achieve what Agencies *A* and *B* wanted to do but by acting lawfully were unable to do. If Agency *C* can do this, why should any agency that wants to make a rule effective immediately bother to comply with APA public participation procedures in the future? If it does not comply, its rule might not be challenged, in which case it has avoided the inconvenience of rulemaking procedures altogether, and, if the rule is challenged, the agency can easily achieve its original purpose

[32] The rulemaking record reflects that the Secretary began to prepare the retroactive wage index rule on August 12, 1983. Rec. at 273. The final rule was published on November 26, 1984—fifteen and a half months later.

by simply pursuing retroactive rulemaking. In either event, it will be able to achieve the desired immediate effectiveness for its rule that it could not have achieved by originally complying with the *prior* notice and comment rulemaking procedures mandated by the APA.

Stripped of rhetoric, the Secretary's argument asks nothing less than that this Court reward him for violating the notice and comment procedures of the APA.[33] If accepted, it would, as the court of appeals correctly observed, allow agencies "to violate the rulemaking requirements of the APA with impunity. . . ." Pet. App. at 14a. But to allow this would clearly be contrary to Congress' direction that "[i]t will . . . be the duty of reviewing courts to prevent avoidance of the requirements of the bill *by any manner or form of indirection*. . . ." S. Rep. No. 752, 79th Cong., 1st Sess. (1945), *reprinted in Legislative History of the Administrative Procedure Act, 1944-1946,* at 217 (emphasis added); *see also Chrysler Corp. v. Brown,* 441 U.S. at 313 ("courts are charged with . . . ensuring that agencies comply with the 'outline of minimum essential rights and procedures' set out in the APA."). The integrity of the rulemaking process requires rejection of the Secretary's "curative" rulemaking argument.[34]

[33] Faced with a similar "curative" retroactive rule issued by the Secretary, the Court of Appeals for the Eleventh Circuit aptly noted:

> In football, if a team gains ten yards on a play in which it commits a five yard penalty, the ball is typically taken back to the original line of scrimmage and the five yard penalty is counted off from there. Adopting the Secretary's approach would be like taking five yards off from the point where the play ended (and thus allowing the team a net five yards gain on a play in which it committed an infraction).

Tallahassee, 815 F.2d at 1455 n.41.

[34] The logical consequences of the Secretary's position are startling. In *Morton v. Ruiz,* 415 U.S. 199 (1974), this Court rejected the government's position that Indians must actually live *on* reservations to qualify for general assistance. It did so in substantial part because the government's rule had not been published in compliance with the APA. 415 U.S. at 230-236. Under the Secretary's "curative" approach, the government would be free to reinstate the "on reservation" rule retroactively by a "curative" publication in accordance with the APA and then proceed to recoup from Mr. Ruiz the amounts he received as a result of this Court's decision.

The Secretary contends that interested parties have the same opportunity to persuade an agency of the error of a proposed rule in notice and comment proceedings undertaken in a curative retroactive rulemaking that they would have had in prospective rulemaking procedures. Brief at 20-21. But, as a practical matter, that is very unlikely. Returning to our hypothetical involving the three agencies which all wanted to make a change in their rules effective immediately, is it really likely that interested persons would have the same opportunity to persuade Agency *C* of the error of its position that they would have to persuade Agency *B*? Having already tried to adopt its proposal as a final rule, Agency *C* is almost certain to be much less open to the criticisms of interested parties than Agency *B*, which has made no such prior commitment to its proposal.[35] Moreover, Agency *C* may have taken actions based on its prior invalidated rule that would cause the agency inconvenience or embarrassment if it accepted commenters' objections to its "curative" proposed retroactive rule—a powerful psychological factor which might well cause it to reject commenters' criticisms but which obviously would not enter into Agency *B*'s evaluation of the public comments.[36]

[35] This concern accounts in part for the many judicial decisions refusing to allow agencies to substitute a postpromulgation comment period for the *prior* notice and comment procedures mandated by the APA. *See, e.g., Natural Resources Defense Council,* 683 F.2d at 767-769; *State of New Jersey v. U.S. EPA,* 626 F.2d 1038, 1049-1050 (D.C. Cir. 1980); *Sharon Steel Corp. v. EPA,* 597 F.2d 377, 381 (3d Cir. 1979); *U.S. Steel Corp. v. EPA,* 595 F.2d 207, 214-215 (5th Cir. 1979), *cert. denied,* 444 U.S. 1035 (1980); *National Tour Brokers Association v. United States,* 591 F.2d 896, 901-903 (D.C. Cir. 1978). As the D.C. Circuit stated in *National Tour Brokers,* a major purpose of requiring prior notice is:

> to see to it that the agency maintains a flexible and open-minded attitude towards its own rules, which might be lost if the agency had already put its credibility on the line in the form of "final" rules. People naturally tend to be more close-minded and defensive once they have made a "final" determination.

591 F.2d at 902 (footnote omitted).

[36] The Secretary, in fact, attempts to rely on such factors to support promulgation of his 1984 retroactive wage index rule. Brief at 20, 38. The

(footnote continues)

Moreover, if the Secretary can apply a "second-chance" retroactive rule against the respondents, what is to prevent him from imposing a "third-chance" retroactive rule if the "second-chance" retroactive rule fails or from imposing a "fourth chance" retroactive rule if the "third-chance" retroactive rule fails? By repeatedly repromulgating retroactive wage index rules, the Secretary could engage respondents and the courts in endless litigation over respondents' *1981* Medicare reimbursement. Forcing respondents to continue to relitigate this matter for a cost reporting year long since past, as the Secretary creates new retroactive rules and new retroactive rulemaking records, is inconsistent with basic notions of justice and fair play and wasteful of judicial resources. *See Tallahassee,* 815 F.2d at 1454 n.38, 1455 & n.41, 1456; *Mason General,* 809 F.2d at 1225; *Albany General Hospital v. Heckler,* 657 F. Supp. 87, 92 (D. Or. 1987), *appeal docketed,* No. 87-3688.

The closest analogy to the Secretary's 1984 retroactive wage index rule is the Secretary's 1986 rule governing the apportionment of malpractice insurance costs. *See* 42 C.F.R. § 413.56. The Secretary published the 1986 rule to "cure" his

(footnote continued)

Secretary's concern is based on the false premise that but for the issuance of the 1984 retroactive wage index rule, *DCHA* would have required recoupment from hospitals that benefited from the wage index that excluded federal government hospital data. But only a small number of hospitals participated in *DCHA*. The district court instructed hospitals that sought payment under the wage index which includes federal government hospital data to file appropriate claims. Pet. App. at 63a. Hospitals which benefited from the 1981 rule obviously would not file such claims. Judge Oberdorfer made it very clear that neither his decision in *DCHA,* nor in the instant case, required recoupment from such hospitals. Pet. App. at 38a-39a.

The Secretary's suggestion that but for the issuance of his retroactive rule, he would have been required to recoup from such hospitals is disingenuous. Although, as discussed below, eight courts of appeals have invalidated the Secretary's 1979 Medicare rule governing the apportionment of malpractice insurance costs, the Secretary has never suggested that he is required to recoup from the hospitals which benefited from that rule. To the contrary, his consistent position has been that it would be unfair to recoup from such hospitals and he is not required to do so. *See* 51 Fed. Reg. 11,149, 11,184, 11,186, 11,187, 11,188 (1986).

1979 malpractice rule after literally scores of courts invalidated his 1979 malpractice rule and ordered payment under the preexisting rule.[37] To date, all nine courts which have considered the issue have refused to allow the Secretary to apply the 1986 malpractice rule retroactively. *See Mason General Hospital; Tallahassee Memorial Regional Medical Center; St. Peter's Medical Center v. Heckler,* 813 F.2d 398 (3d Cir. 1987); *Albany General Hospital; Miami General Hospital v. Bowen,* 652 F. Supp. 812 (S.D. Fla. 1986); *West Anaheim Community Hospital v. Bowen,* CCH Medicare and Medicaid Guide ¶ 36,609 (C.D. Cal. July 13, 1987); *St. Joseph's Hospital v. Bowen,* CCH Medicare and Medicaid Guide ¶ 36,437 (D. Ariz. Apr. 15, 1987); *Bethesda Community Hospital v. Heckler,* CCH Medicare and Medicaid Guide ¶ 36,654 (S.D.N.Y. Aug. 5, 1987); *Children's Hospital of San Francisco v. Bowen,* CCH Medicare and Medicaid Guide ¶ 36,679 (E.D. Cal. Sep. 3, 1987).

The case against the Secretary is even stronger here.[38] Unlike the 1986 malpractice rule, the 1984 retroactive wage index rule is a *cost limit* rule and thus is subject to the express

[37] The appellate court decisions reaching this result are listed in *Mason General Hospital,* 809 F.2d at 1223 n.2. As noted there, this Court denied the Secretary's petitions for *certiorari* in all three cases in which they were filed.

[38] The instant case, and the litigation involving the Secretary's 1986 retroactive malpractice rule, are part of a much broader pattern of conduct for which the Secretary has earned a well-deserved reputation for "hardball" litigation tactics, if not for outright abuse of the judicial system. HHS is the only federal agency that has actively pursued a policy of intra-circuit nonacquiescence. *See, e.g., Murray v. Heckler,* 722 F.2d 499, 503 (9th Cir. 1983); *Hillhouse v. Harris,* 715 F.2d 428, 430 (8th Cir. 1983); *Valdez v. Schweiker,* 575 F. Supp. 1203, 1206 (D. Colo. 1983). In a prime example, the Secretary continued to litigate the validity of his Medicare labor/delivery room day apportionment policy in the D.C. Circuit even though the court of appeals had twice invalidated that policy. *See Stormont-Vail Regional Medical Center v. Bowen,* 645 F. Supp. 1182, 1186-1190 (D.D.C. 1986). Indeed, he even continued to litigate the issue against the same hospitals that had prevailed in the earlier suits. *Id.* at 1191-1192. In the past two years, this Court has on three separate occasions unanimously rejected extreme positions adopted by the Secretary on jurisdictional matters. *Bethesda Hospital Association v. Bowen,* 108 S.Ct. 1255 (1988); *Bowen v. City of New York,* 476 U.S. 467 (1986); *Bowen v. Michigan Academy of Family Physicians,* 476 U.S. 667 (1986).

prospectivity requirement established by section 223(b). Moreover, here the Secretary has applied his retroactive rule to recoup from the respondents monies that he previously paid them as a result of a final court judgment, something he has not done in the case of the 1986 retroactive malpractice rule and indeed has even strongly implied would be unlawful for him to do. *See* 51 Fed. Reg. 11,149 (col. 3), 11,186 (cols. 2 and 3), and 11,187 (col. 2) (1986) ("Adoption of this final rule is not unlawful since all final, non-appealable judgments mandating . . . reimbursement [under the rule in effect before 1979] will be complied with fully.").

3. The Secretary argues that this case does not involve the "prejudice and unfair surprise" which normally make retroactivity objectionable. Brief at 19-20. He asserts that the invalid 1981 wage index rule furnished respondents with "ample notice" of the standard that the Secretary would apply to them and that respondents were not entitled to rely on any other standard. *Id.* at 39.

Contrary to the Secretary's assertion, the original 1981 rule did not furnish the respondents with "ample notice." The rule was published without any advance notice on June 30, 1981, to become effective the next day, thereby violating not only the APA's notice and comment requirements, but also the APA's thirty day delayed effective date requirement (5 U.S.C. § 553(d)). Like other business entities, hospitals operate under established labor and supply contracts that generally cannot be terminated at will. Significantly, the Secretary had recognized in the past that "accommodation to a lower cost level may require adjustment of staff schedules and purchasing practices that is hard to accomplish quickly" and had allowed *one or two year* grace periods to allow hospitals sufficient time to effect such adjustments before applying significant new cost limit rules. 43 Fed. Reg. 25,873 (1978), J.A. at 77; *see also* 41 Fed.

Reg. 36,992 (1976). The Secretary's assertion that the one day's prior notice furnished by the *invalid* 1981 schedule was "ample" is patently absurd.[39]

If the Secretary had promulgated the 1981 wage index rule in accordance with APA procedures, he would have had to publish the final rule by June 1, 1981, to make it effective July 1, 1981. 5 U.S.C. § 553(d) (App. at 2). And to satisfy the prior notice and comment requirements of the APA, the Secretary would have had to publish a proposed notice several months before June 1, 1981.[40] 5 U.S.C. § 553(b)-(c) (App. at 1-2). If the Secretary had followed this procedure, respondents might well have had sufficient time to take the necessary cost-cutting measures to prevent, or at least significantly mitigate, cost limit disallowances. Moreover, if the Secretary had published a valid *prior* notice, respondents might well have had a *fair* opportunity to dissuade the Secretary from adopting the proposed change or to persuade him to delay the change or grant temporary grace periods, as he had done in the past.

Nor were respondents required to rely on the Secretary's invalid rule, as the Secretary argues. Respondents were entitled instead to "rely[ ] upon [their] legal rights."[41] *Forbes Pioneer Boat Line v. Board of Commissioners,* 258 U.S. 338, 340

[39] In their comments on the Secretary's 1984 proposed retroactive rule, respondents reminded the Secretary of his prior recognition of the difficulties involved in making cost adjustments quickly and of his prior practice of granting grace periods (Rec. at 149-150), but the Secretary did not respond to respondents' comments in his final notice (J.A. at 29-47).

[40] The Secretary's 1984 final retroactive wage index rule was published on November 26, 1984, more than nine months after the proposed rule was published on February 17, 1984. Based on a review of all final Medicare regulations published by the Secretary in 1987, respondents have determined that, on the average, 409 days elapsed between publication of the proposed rule and publication of the final rule.

[41] This is particularly true because the 1981 wage index was patently invalid. The *DCHA* court found that the Secretary's invocation of the "good cause" exception "does not survive even deferential scrutiny," much less the strict scrutiny normally applied in this circumstance. Pet. App. at 58a. The Secretary essentially argued that "mere incantation" by the agency was sufficient to trigger the "good cause" exception. *Id.*

(1922). They succe[illegible]fully pursued those rights in *DCHA* and are rightfully entitled to the amounts paid to them by the Secretary as a result of that decision.

4. The Secretary relies on several early decisions of this Court which he characterizes as involving "the analogous question of the validity of curative legislation." Brief at 18-19. However, the only cited case that bears any resemblance to the facts here is *Forbes Pioneer Boat Line,* which rejected the curative legislation under review. Typical of the other cases is *Graham v. Goodcell,* 282 U.S. 409 (1931), which addressed a statute that allowed the Commissioner of Internal Revenue to collect or retain certain taxes even though, due to a misunderstanding of the law on his part, the statute of limitations for collection had previously run. In upholding the statute, this Court stressed:

> This is not a case of an attempt retroactively to create a liability in relation to a transaction as to which no liability had previously attached. There is no question here as to the original liability of the taxpayers. The tax was a valid one. . . .

282 U.S. at 426 (footnote omitted). In contrast, the instant case does involve "an attempt retroactively to create a liability in relation to a transaction as to which no liability had previously attached." The tax in *Graham* was "valid," but the 1981 wage index rule involved here was determined by a final court judgment *not* to be "valid."

Moreover, "curative" retroactive rulemaking is not "analogous to" curative legislation. It is one thing for Congress to decide to remedy an inadvertent error of its agents through curative legislation. It is quite another for an agency on its own initiative to decide to "remedy" its own culpable violation of the procedures mandated by Congress through a retroactive rule which effectively allows it to circumvent Congress' commands.

It is also clear that even "curative legislation could, if carried too far, encourage irresponsible official conduct." Slawson, *Constitutional and Legislative Considerations in Retroactive Lawmaking,* 48 Calif. L. Rev. 216, 239 (1960), *quoted in Van Emmerik v. Janklow,* 454 U.S. 1131, 1133-1134 (1982)

(White & Blackmun, JJ., dissenting from dismissal of appeal). There is absolutely no question that the curative retroactive rulemaking pursued by the Secretary here and elsewhere has had that effect and must therefore be rejected. *See Tallahassee,* 815 F.2d at 1456 ("This court cannot condone such potential abuse.").

IV. ASSUMING *ARGUENDO* THE APPLICABILITY OF A BALANCING TEST, THE ILL EFFECTS OF THE SECRETARY'S RETROACTIVE WAGE INDEX RULE FAR EXCEED ANY POSSIBLE STATUTORY INTEREST UNDERLYING THE RULE.

In *Chenery,* this Court developed a balancing test for determining the legality of retroactive adjudicative rules. The test is whether the "mischief of producing a result which is contrary to a statutory design or to legal and equitable principles . . . is greater than the ill effect of the retroactive application of a new standard. . . ." [42] 332 U.S. at 203.

For the reasons discussed in the prior sections, respondents do not believe that a balancing test is properly applicable in the context of legislative rules in general or Medicare cost limit rules in particular. However, assuming *arguendo* that a balancing test is proper, the balance clearly falls in respondents' favor.[43] As discussed in section IV.A. below, the ill effects of the Secretary's 1984 retroactive wage index rule are substantial.

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[42] The D.C. Circuit has stated that "[w]hich side of this balance preponderates is in each case a question of law, resolvable by reviewing courts with no overriding obligation of deference to the agency decision. . . ." *Retail Union,* 466 F.2d at 390. *Accord, Mason General,* 809 F.2d at 1224.

[43] Although respondents address the merits of the Secretary's 1984 retroactive wage index rule in the context of a balancing test, they also contend that the factors discussed in § IV.B. below demonstrate that the rule is arbitrary and capricious even under the standard applied to prospective rules. Respondents note that the Secretary's discussion of the arbitrary and capricious issue is marked by a curious "heads-I-win, tails-you-lose" mentality. On the one hand, the Secretary asks this Court to determine that the rule is not arbitrary and capricious. Brief at 36-40. On the other hand, he insists that for purposes of this determination, the Court must presume that the rule is substantively valid. Id. at 38 n.30. The Secretary cannot have it both ways. The Court cannot determine whether the Secretary's rule is

(footnote continues)

And as discussed in § IV.B. below, the Secretary's 1984 retroactive wage index rule has produced, not prevented, a result which is contrary both to the statutory design and to legal and equitable principles.

A. The Ill Effects Of The Secretary's Retroactive Wage Index Rule Are Substantial.

As discussed in the preceding sections, the ill effects of the Secretary's 1984 retroactive wage index rule have been substantial:

(1) The rule apparently marks the first and only time that an administrative agency has applied a retroactive rule to recoup monies previously paid by the agency as a result of a final court judgment. It also apparently marks the first and only time that an agency has by its own admission attempted to reverse a lower court judgment not through the appeals process but through retroactive rulemaking.

(2) The rule is totally devoid of "future effect." It applies solely to cost reporting years beginning in a fifteen month period that closed more than two years before the 1984 rule was even promulgated.

(footnote continued)

arbitrary and capricious without taking a hard look at the substantive validity of the rule. *See Motor Vehicle Manufacturers,* 463 U.S. at 42 ("If Congress established a presumption from which judicial review should start, that presumption . . . is . . . *against* changes in current policy that are not justified by the rulemaking record." (original emphasis)).

The Secretary's aversion to discussing the merits is particularly ironic given his repeated assertion (which he apparently asks the Court to accept on faith) that respondents received "windfalls." *See, e.g.,* Brief at 38, 40 n.33. Considering that the alleged "windfalls" resulted entirely from application of the Secretary's own preexisting rule, the Secretary's bald assertion is, to say the least, quite curious. As the absence of any supporting citations in the Secretary's brief suggests, there is not a scintilla of evidence in the record to support the Secretary's assertion. Moreover, all of the respondents were not-for-profit hospitals, and the Medicare reimbursement scheme did not provide a "profit" factor for such hospitals. Respondents received the lower of their costs or the cost limits. A hospital that at the most is reimbursed its costs can hardly be accused of receiving "windfalls." Pet. App. at 36a.

(3) The rule has the effect of rewarding the Secretary for his illegal conduct. It allows him to achieve what he could not have achieved if he had acted lawfully on June 30, 1981, when he published the 1981 schedule of limits.

The Secretary's retroactive wage index rule "dramatically departed from prior practice." Pet. App. at 35a. The Secretary had included wage data from all hospitals (including federal government hospitals) in determining the wage indexes for his prior two schedules. He had also included income from all employees (including federal employees) in determining the per capita income classifications used to measure "economic environment" in the five schedules before that. There was no intervening legislation that required, or made desirable, a change in the Secretary's methodology for measuring "economic environment." The Secretary has never explained why it suddenly became so urgent to change the methodology that for his eighth, and final, schedule of routine cost limits he resorted to the drastic and unprecedented measure at issue in this case.

B. No Statutory Interests Support Application Of The Secretary's Retroactive Wage Index Rule.

The Secretary's retroactive wage index rule does not serve any statutory interest.[44] As Judge Oberdorfer found, application of the Secretary's retroactive wage index rule contravened

[44] Respondents' ability to address the merits of the 1984 retroactive wage index rule has been hampered by the Secretary's refusal to file the complete rulemaking record. *See* plaintiff's motion to compel and supporting memoranda and exhibits, *Georgetown* Docket Nos. 9, 12, J.A. at 5. The district court ruled that "the ultimate question here may be fairly resolved without reviewing the documents and portions of documents withheld by the Secretary, so long as . . . all of the documents withheld by the Secretary are available so that in the event of an appeal, the Court of Appeals may, *if necessary,* consider whether the record before this Court satisfies the 'completeness' requirements of the APA. . . ." Memorandum dated Sept. 23, 1985, slip op. at 3 (original emphasis), *Georgetown* Docket No. 14, J.A. at 6. A week later the Secretary filed with the court two volumes of withheld materials under seal. *Georgetown* Docket No. 29, J.A. at 6. Because of its resolution of this case, the court of appeals did not find review of these materials necessary, but if this Court decides to apply a balancing test, it may wish to review the materials. The contents are, of course, known to the Secretary, but not to respondents.

Medicare statutory interests by underreimbursing respondents' costs. Pet. App. at 36a. Moreover, the rule is arbitrary and capricious because the Secretary failed to take into account many relevant factors and drew conclusions clearly contrary to the evidence before him. *See Motor Vehicle Manufacturers,* 463 U.S. at 43.

1. In the 1984 proposed notice, the Secretary provided the following explanation for his decision to exclude federal government hospital data:

> As a result of prior schedules that were issued, we received correspondence concerning the inequity of including Federal hospital wages in developing the wage index. We examined this issue and found that including Federal hospital wages resulted in wage index values that were unrealistically low in areas without Federal hospitals in comparison to adjacent areas with Federal hospitals. . . . Yet these adjacent areas with an unrealistically low wage index were competing for the same employees as those areas whose only difference in average wages was the fact that a Federal hospital was located in the SMSA. . . . Including Federal hospital wage data resulted in wage indexes that did not reflect the differences in wages from area to area. Therefore, in order to correct this inaccuracy, we excluded Federal hospital data from the 1981 wage index.

49 Fed. Reg. 6,177 (col. 1) (1984), J.A. at 20-21. The evidence in the record clearly contradicts this explanation.

The "correspondence" referred to by the Secretary is apparently a letter dated December 12, 1980, from the Memorial Hospitals Association, which represents hospitals in the Modesto, California SMSA. Rec. at 504-506. The Association complained about the disparity in the Secretary's wage indexes for three contiguous SMSAs—Modesto, Fresno, and Stockton. *Id.* at 504. The Association alleged a "close parity" in actual hospital wages for the three SMSAs and attributed the disparity in the Secretary's wage indexes for the three SMSAs to the inclusion of government hospital data. *Id.* at 504-505. The

Association requested *not* the exclusion of government hospital data, but the consolidation of the three SMSAs into a single economic unit. *Id.* at 505.

Instead of adopting the Association's suggestion, the Secretary elected to exclude federal government hospital data in determining the wage indexes. The evidence clearly shows, however, that this did virtually nothing to eliminate the disparity in the Secretary's wage indexes for the three SMSAs. The wage indexes in the 1980 schedule, which were based on 1978 BLS data that *included* federal government hospital data, were as follows:

Modesto— .9527
Fresno— 1.1454
Stockton— 1.2994.

Rec. at 489. The wage indexes in the 1981 schedule, which were based on 1979 BLS data that *excluded* federal government hospital data, were as follows:

Modesto— 1.0250
Fresno— 1.1266
Stockton— 1.3047.

Id. The effect of the exclusion was to decrease somewhat the differential between Stockton and Modesto (from 36.4% to 27.3%) but to increase somewhat the differential between Stockton and Fresno (from 13.4% to 15.8%).

An internal agency report acknowledged that "removal of Federal hospitals from the data base did not substantially improve Modesto's position." *Id.* at 486. Thus, if the three SMSAs truly had comparable hospital wages (as the evidence suggests (Rec. at 497-500)), the exclusion of federal government hospital data obviously was not the solution to the problem. The agency's internal report concluded that some other factors in the BLS data or the Secretary's methodology accounted for the distortion in the relative values of the Secretary's wage indexes for the three SMSAs. *See* Rec. at 488. The agency nonetheless proceeded to exclude federal government hospital data *for all SMSAs* even though it knew that this did not resolve the identified problem even for the three SMSAs it had studied.

Respondents have accurately summarized the *only evidence in the record* regarding the effect of federal government hospital data on the wage indexes of adjacent SMSAs. Accordingly, the record reveals that "the agency has . . . offered an explanation for its decision that runs counter to the evidence before the agency. . . ." *Motor Vehicle Manufacturers,* 463 U.S. at 43.

2. According to the Secretary, the purpose of his wage index was to reflect "area variations in wage levels." 49 Fed. Reg. 6,176 (col. 2) (1984), J.A. at 19. He attempted to justify the exclusion of federal government hospital data from his wage index formula on the ground that "the wages paid by a Federal hospital do not reflect the local economy since Federal wages are based primarily on national pay scales." 49 Fed. Reg. 46,497 (col. 1) (1984), J.A. at 34. He conceded, however, that this was only a "belief" (49 Fed. Reg. 46,497 (col. 3) (1984), J.A. at 37) and a "theory" (49 Fed. Reg. 46,498 (col. 2) (1984), J.A. at 39). He produced no evidence to support his "belief" or "theory" that all federal hospitals pay according to the same pay scale.

In their public comments, respondents reminded the Secretary of certain evidence from the *DCHA* case. Rec. at 150-151. During that litigation, respondents had asked BLS to calculate the average monthly wage for federal hospitals in the Washington, D.C.-Maryland-Virginia SMSA and for four other SMSAs *chosen at random by BLS. Id.* The results were as follows:

SMSAs	Average Monthly Wages
San Francisco-Oakland, CA	$1,564.75
New York, NY-NJ.....	1,485.49
Washington, D.C.-MD-VA	1,323.47
San Antonio, TX	1,268.30
Norfolk-Virginia Beach-Portsmouth, VA-NC	1,175.48

Id. at 151.

The data provided for these five SMSAs suggested that federal hospital wages roughly reflected regional wage and cost of living differences: the New York and San Francisco SMSAs, which might be expected to have relatively high wage rates and costs of living, were also associated with high federal hospital average monthly wages. And the San Antonio and Norfolk-Virginia Beach-Portsmouth SMSAs, which might be expected to have relatively low wage rates and costs of living, were associated with significantly lower federal hospital average monthly wages. As might be expected, federal hospital average monthly wages for the Washington, D.C. SMSA fell between these extremes.

The differences reflected in the BLS data for these five SMSAs were not minimal. Indeed, the federal hospital average monthly wage in the San Francisco-Oakland SMSA was 33% higher than in the Norfolk-Virginia Beach-Portsmouth SMSA. It is hard to believe that this could happen if, as the Secretary "believed," the hospitals in the two SMSAs paid according to the same scale. Based in part upon this evidence, the *DCHA* court stated that "plaintiffs have demonstrated that the Secretary may have been unaware or even mistaken about some facts central to the decision" and concluded that the Secretary "may have . . . erred in [his] assumption that federal government hospitals 'typically' set their wages according to 'national pay scales.' " Pet. App. at 59a & n.8.

The Secretary's response to respondents' comments regarding the evidence in *DCHA* is clearly unsatisfactory. He stated that his wage index is riddled with numerous "technical deficiencies," any of which "could account for the discrepancy in average monthly wages" noted by respondents. 49 Fed. Reg. 46,498 (col. 1) (1984), J.A. at 39. His explanation is unconvincing, however, given that the federal hospitals with the higher wages were the ones located in the SMSAs with the higher costs of living. Moreover, if the Secretary's explanation were correct, any attempt to improve the accuracy of the wage index through a single change appears pointless. If the "technical deficiencies" in the Secretary's data were so serious that they produced a 33% difference in the average monthly

wage figures of hospitals which, in fact, had the same wages (as the Secretary suggested), then the only rational conclusion is that the wage index data was hopelessly flawed.

Agency reliance on a faulty study is arbitrary and capricious. *Walter O. Boswell Memorial Hospital v. Heckler,* 749 F.2d at 803; *Almay, Inc. v. Califano,* 569 F.2d 674, 682 (D.C. Cir. 1977). Here, the Secretary failed to do any study whatsoever. Instead he continued to rely on the same unexamined "assumption" used in the original 1981 schedule, even though the *DCHA* court had already concluded that that "assumption" may have been erroneous and the public comments specifically reminded the Secretary of this fact (Rec. at 151).

The Secretary's failure to do his homework is also reflected in his erroneous assertion that only a "few hospitals" are "located in an area with Federal hospital employees." 49 Fed. Reg. 6,178 (col. 2) (1984), J.A. at 26; 49 Fed. Reg. 46,499 (col. 3) (1984), J.A. at 45. During 1980, there were, in fact, 359 federal government hospitals, and they accounted for more than 10% of total hospital wages ($4,927 million of $46,972 million). *See* American Hospital Association, *AHA Guide to the Health Care Field* A8 (Table 1) (1981). Analysis of an exhibit filed by the Secretary in *DCHA* reveals that at least one federal government hospital was located in 46.6% of all SMSAs. *See DCHA* Docket No. 17, Notice of Filing by Defendant, dated Jan. 26, 1983 (Defendant's Exhibit 8).[45]

In *DCHA,* the court criticized the Secretary for failing to properly consider the extent of the presence of federal government hospitals. Pet. App. at 59a & n.8. The Secretary nonetheless continued to ignore this "relevant factor" in promulgating the 1984 retroactive wage index rule.

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[45] The Secretary's Exhibit 8 consists of two tables, one furnishing data by SMSA based on the inclusion of federal government hospitals and the other furnishing data by SMSA based on the exclusion of federal government hospitals. The "total wages" column in the table which includes federal government hospitals is greater than in the table which excludes such hospitals for 116 of the 249 SMSAs listed, reflecting the presence of federal government hospitals in those SMSAs. (The "total wages" column in the two tables is identical for the other 133 SMSAs, thus obviously reflecting an absence of federal government hospitals in those SMSAs.)

3. Throughout the preamble to the final rule, the Secretary asserted that if federal wages affected the local labor market, then the wage index for an SMSA would not be significantly affected by the exclusion of federal hospital data because the wages of federal and non-federal hospitals would be comparable. He noted that for the five SMSAs cited in respondents' comments (discussed above), the average monthly wage for the federal hospitals was higher than for the non-federal hospitals and concluded that this proved his "*theory* that Federal hospitals are not paying local wages." 49 Fed. Reg. 46,498 (col. 2) (1984) (emphasis added), J.A. at 39. He stated that "[i]f the Federal hospitals were paying local wages, the average monthly wage for Federal hospitals would be the same figure as the average monthly wage not including Federal hospitals for the same SMSA." *Id.*

The Secretary's conclusion was based on the premise that an SMSA is a single labor market, but the record proves that premise to be false. Rec. at 96-141 and 152-153. Most SMSAs consist of an urban "core" and a large suburban "ring." For instance, the District of Columbia SMSA includes Calvert, Charles, Frederick, Montgomery and Prince George's Counties in Maryland, and Alexandria, Fairfax, Falls Church, Manassas, and Manassas Park Cities, and Arlington, Fairfax, Loudoun, Prince William, and Stafford Counties in Virginia.[46] Rec. at 128; *see also* 48 Fed. Reg. 39,874 (1983). Labor costs are much lower in Loudoun, Prince William, and Stafford Counties (all of which are largely rural) than in the District of Columbia. Rec. at 128. Indeed, according to information furnished by BLS for 1981, if the computations for the District of Columbia and the surrounding suburbs were made separately, the wage index (excluding federal hospital data) would be 1.3286 for the District of Columbia and 1.0281 for the Washington suburbs, a difference of .3005 (or 29%). Id. at 124.

[46] The SMSA boundaries extend all the way to West Virginia to the West, Pennsylvania to the North, the Chesapeake Bay to the East, and more than halfway to Richmond to the South.

Nor is the District of Columbia SMSA unusual in this regard, as the following results (taken from a sample of four other SMSAs from which federal hospital data was excluded) reflect:

City	Core Jurisdiction	Surrounding Suburban Jurisdictions	Core to Suburban Relationship
Chicago	1.2347	.9547	+29%
Cleveland	1.2182	.9801	+24%
Minneapolis/St. Paul	1.0344	.9884	+ 5%
Philadelphia/Camden	1.2456	1.0807	+15%

Rec. at 124.

Thus, the fact that the Secretary found, in five SMSAs, that the average monthly wage of the federal hospitals was higher than the average monthly wage of the non-federal hospitals does not prove, as the Secretary assumed, that federal hospitals do not affect the local labor market. If the Secretary had checked, he unquestionably would have found that the average monthly wage of non-federal hospitals in the urban "core" of these SMSAs is higher than the average monthly wage of all the non-federal hospitals (core and ring) in the SMSAs. What the Secretary's finding almost certainly reflects is not that federal hospitals are isolated from local conditions but that, as is clearly the case in the District of Columbia SMSA, most federal hospital employees work in the urban "core," which is a different labor market (with significantly higher wages) than the suburban "ring."

As a practical matter, the Secretary's assumption that wages at federal hospitals do not affect the local economy is contrary to common sense. Non-federal hospitals will not want to lose their best employees to federal hospitals. Consequently, as a matter of simple economic reality, they have little choice but to offer wages competitive with the federal hospitals in their market.

4. The Secretary asserted that the exclusion of federal hospital data produced a more accurate wage index. 49 Fed.

Reg. 6,177 (col. 1) (1984), J.A. at 21. The evidence in the record proves otherwise.

The District of Columbia SMSA is a case in point. According to *1981* BLS data, a separate calculation for non-federal District of Columbia hospitals *only (i.e.,* non-federal urban "core" hospitals only) would yield a wage index of 1.3286. Rec. at 124. Yet, as a result of the inclusion of wage data from hospitals in the suburban "ring" of the SMSA, the Secretary's retroactive wage index rule imposed a 1.1547 wage index on District of Columbia hospitals. 49 Fed. Reg. 46,501 (col. 1) (1984). The wage index which included federal hospital data (which the Secretary originally used to pay the District of Columbia respondents) was 1.1953. While that index was far less than hospitals in the District of Columbia should have received (according to the BLS data), it was nonetheless considerably closer to the correct figure (1.3286) than the wage index which the Secretary retroactively imposed (1.1547).[47] Thus, the inclusion of federal hospital data improved the accuracy of the Secretary's wage index because it mitigated the unfairness of the Secretary's failure to differentiate between the urban "core" and the suburban "ring" within an SMSA.

The elimination of federal hospital data—unaccompanied by any differentiation between the urban "core" and the suburban "ring"—was arbitrary and capricious. The effect for urban "core" hospitals was to eliminate from the wage pool the wage data from the federal hospitals with which they competed but to retain in the pool the wage data from distant suburban hospitals with which they did not compete.[48]

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[47] Although the reduction in the wage index hurt hospitals in the urban core, it did not hurt the suburban hospitals. Because of the lower wages in the suburbs, suburban hospitals should have been well below the limit, whichever wage index was used to compute the limit. The wage index was used to compute a "limit," not a "rate."

[48] During 1981, the District of Columbia had three federal hospitals, all of which were large—Walter Reed Army Medical Center (5,060 employees), St. Elizabeth's Hospital (4,068 employees), and Veterans Administration

(footnote continues)

The perverse results produced by the Secretary's methodology are also well-illustrated by the St. Cloud SMSA. Six hospitals were located in the St. Cloud SMSA. Rec. at 75. Two were large hospitals located in the City of St. Cloud (population 42,566)—St. Cloud Hospital with 522 hospital beds and a federal government hospital with 818 hospital beds.[49] *Id.* The remaining four were small hospitals (bed sizes ranging from 26 to 46) located in small towns (populations ranging from 1,569 to 3,709) many miles away from the City of St. Cloud. *Id.* Under the Secretary's methodology, the wage index for the St. Cloud SMSA was established by averaging the wages of St. Cloud Hospital with the lower wages of the four small, distant hospitals with which it did not compete for employees, but by excluding from the pool the higher wages of the large, nearby federal government hospital with which it did compete for employees. *Id.* at 82. Thus, under the Secretary's methodology, it was virtually inevitable that St. Cloud Hospital's costs would be above the cost limits, no matter how efficiently it operated. The Secretary's methodology not only mixed apples with oranges, but did not even include all the apples in the mix. *See Georgetown,* Pet. App. at 37a (noting that the Secretary had "failed to confront with sufficient particularity . . . the effect of area differentials and *relevant* labor markets on average hospital wage levels." (original emphasis)).

5. In the preamble to the retroactive wage index rule, the Secretary addressed whether he should establish separate wage indexes for the urban "core" and the suburban "ring" within an SMSA. 49 Fed. Reg. 46,498 (col. 2) (1984), J.A. at 40. He acknowledged that "in principle" this "could provide a more

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(footnote continued)

Medical Center (1,698 employees). *See* American Hospital Association, *AHA Guide to the Health Care Field* A50 (1981). Both Walter Reed and St. Elizabeth's had far more employees than any non-federal hospital in the District. Of the fourteen non-federal hospitals in the District, six had fewer than 1,000 employees, five had more than 1,000 but fewer than 2,000, and three had more than 2,000 but fewer than 3,000. Id. Because of their size, the three federal hospitals accounted for 37.5% (10,826 divided by 28,904) of all hospital employees in the District. *Id.*

[49] Convalescent and nursing care ("C&NC") beds and bassinets have been excluded from the bed totals.

precise wage index." *Id.* However, he noted that the BLS data contains numerous "technical deficiencies" and concluded, *with no explanation,* that "disaggregating the data into 'core-ring' indexes would only magnify the inherent limitations of the BLS data and increase the potential for distortion. . . ." *Id.*

This same rationale for inaction should have been equally applicable to the Secretary's proposal to exclude federal government hospital data. If "disaggregating" the BLS data into "core-ring" indexes "would only magnify the inherent limitations of the BLS data and increase the potential for distortion," then why would "disaggregating" the BLS data to exclude federal hospital data not have the same effect? The Secretary provided no explanation for his position, which is obviously internally inconsistent.

CONCLUSION

For the foregoing reasons, the Court should affirm the judgment below.

Respectfully submitted,

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APPENDIX

STATUTES AND REGULATIONS INVOLVED

1. **5 U.S.C. § 551(4)—**

For the purpose of this subchapter—

* * * * *

(4) "rule" means the whole or a part of an agency statement of general or particular applicability and future effect designed to implement, interpret, or prescribe law or policy or describing the organization, procedure, or practice requirements of an agency and includes the approval or prescription for the future of rates, wages, corporate or financial structures or reorganizations thereof, prices, facilities, appliances, services or allowances therefor or of valuations, costs, or accounting, or practices bearing on any of the foregoing.

2. **5 U.S.C. § 553(b)-(d)—**

(b) General notice of proposed rule making shall be published in the Federal Register, unless persons subject thereto are named and either personally served or otherwise have actual notice thereof in accordance with law. The notice shall include—

(1) a statement of the time, place, and nature of public rule making proceedings;

(2) reference to the legal authority under which the rule is proposed; and

(3) either the terms of substance of the proposed rule or a description of the subjects and issues involved.

* * * * *

(c) After notice required by this section, the agency shall give interested persons an opportunity to participate in the rule making through submission of written data, views, or arguments with or without opportunity for oral

presentation. After consideration of the relevant matter presented, the agency shall incorporate in the rules adopted a concise general statement of their basis and purpose. . . .

(d) the required publication or service of a substantive rule shall be made not less than 30 days before its effective date, except—

(1) a substantive rule which grants or recognizes an exemption or relieves a restriction;

(2) interpretive rules and statements of policy; or

(3) as otherwise provided by the agency for good cause found and published with the rule.

3. 5 U.S.C. § 706—

To the extent necessary to decision and when presented, the reviewing court shall decide all relevant questions of law, interpret constitutional and statutory provisions, and determine the meaning or applicability of the terms of an agency action. The reviewing court shall—

(1) compel agency action unlawfully withheld or unreasonably delayed; and

(2) hold unlawful and set aside agency action, findings, and conclusions found to be—

(A) arbitrary, capricious, an abuse of discretion, or otherwise not in accordance with law;

(B) contrary to constitutional right, power, privilege, or immunity;

(C) in excess of statutory jurisdiction, authority, or limitations, or short of statutory right; [or]

(D) without observance of procedure required by law;

* * * * *

4. 42 U.S.C. § 1395x(v)(1)(A) (Section 1861(v)(1)(A) of the Social Security Act)—

The reasonable cost of any services shall be the cost actually incurred, excluding therefrom any part of incurred cost found to be unnecessary in the efficient delivery of needed health services, and shall be determined in accordance with regulations establishing the method or methods to be used, and the items to be included, in determining such costs for various types or classes of institutions, agencies, and services. . . . In prescribing the regulations referred to in the preceding sentence, the Secretary shall consider, among other things, the principles generally applied by national organizations or established prepayment organizations (which have developed such principles) in computing the amount of payment, to be made by persons other than the recipients of services, to providers of services on account of services furnished to such recipients by such providers. Such regulations may provide for determination of the costs of services on a per diem, per unit, per capita, or other basis, may provide for using different methods in different circumstances, may provide for the use of estimates of costs of particular items or services, may provide for the establishment of limits on the direct or indirect overall incurred costs or incurred costs of specific items or services or groups of items or services to be recognized as reasonable based on estimates of the costs necessary in the efficient delivery of needed health services to individuals covered by the insurance programs established under this subchapter, and may provide for the use of charges or a percentage of charges where this method reasonably reflects the costs. Such regulations shall (i) take into account both direct and indirect costs of providers of services (excluding therefrom any such costs, including standby costs, which are determined in accordance with regulations to be unnecessary in the efficient delivery of

services covered by the insurance programs established under this subchapter) in order that, under the methods of determining costs, the necessary costs of efficiently delivering covered services to individuals covered by the insurance programs established by this subchapter will not be borne by individuals not so covered, and the costs with respect to individuals not so covered will not be borne by such insurance programs, and (ii) provide for the making of suitable retroactive corrective adjustments where, for a provider of services for any fiscal period, the aggregate reimbursement produced by the methods of determining costs proves to be either inadequate or excessive.

5. Pub. L. No. 92-603, § 223(b) (1972)—

The third sentence of section 1861(v)(1) of [the Social Security] Act is amended by striking out the comma after "services," where it last appears and inserting in lieu thereof the following: "may provide for the establishment of limits on the direct or indirect overall incurred costs or incurred costs of specific items or services or groups of items or services to be recognized as reasonable based on estimates of the costs necessary in the efficient delivery of needed health services to individuals covered by the insurance programs established under this title,".

6. 42 C.F.R. § 413.9(b)(1)—

(b) *Definitions*—(1) *Reasonable cost.* Reasonable cost of any services must be determined in accordance with regulations establishing the method or methods to be used, and the items to be included. The regulations in this part take into account both direct and indirect costs of providers of services. The objective is that under the methods of determining costs, the costs with respect to individuals covered by the program will not be borne by individuals not so covered, and the costs with respect to individuals not so covered will not be borne by the program. These regulations also provide for the making of suitable retroactive adjustments after the provider has submitted fiscal

and statistical reports. The retroactive adjustment will represent the difference between the amount received by the provider during the year for covered services from both Medicare and the beneficiaries and the amount determined in accordance with an accepted method of cost apportionment to be the actual cost of services furnished to beneficiaries during the year.

7. 42 C.F.R. § 413.30(a), (b)(3)—

(a) *Introduction*—(1) *Scope.* This section implements section 1861(v)(1)(A) of the Act, by setting forth the general rules under which HCFA may establish limits on provider costs recognized as reasonable in determining Medicare program payments. . . .

* * * * *

(2) *General principle.* Reimbursable provider costs may not exceed the costs estimated by HCFA to be necessary for the efficient delivery of needed health services. HCFA may establish estimated cost limits for direct or indirect overall costs or for costs of specific items or services or groups of items or services. These limits will be imposed prospectively and may be calculated on a per admission, per discharge, per diem, per visit, or other basis.

(b) *Procedure for establishing limits.*

* * * * *

(3) Prior to the beginning of a cost period to which revised limits will be applied, HCFA will publish a notice in the *Federal Register,* establishing cost limits and explaining the basis on which they were calculated.

8. 42 C.F.R. § 413.64(a)(1), (b), (f)—

(a) *Principle*—(1) *Reimbursement on a reasonable cost basis.* Providers of services paid on the basis of the reasonable cost of services furnished to beneficiaries will

receive interim payments approximating the actual costs of the provider. These payments will be made on the most expeditious schedule administratively feasible but not less often than monthly. A retroactive adjustment based on actual costs will be made at the end of a reporting period.

* * * * *

(b) *Amount and frequency of payment.* Medicare states that providers of services will be paid the reasonable cost of services furnished to beneficiaries. Since actual costs of services cannot be determined until the end of the accounting period, the providers must be paid on an estimated cost basis during the year. While Medicare provides that interim payments will be made no less often than monthly, intermediaries are expected to make payments on the most expeditious basis administratively feasible. Whatever estimated cost basis is used for determining interim payments during the year, the intent is that the interim payments shall approximate actual costs as nearly as is practicable so that the retroactive adjustment based on actual costs will be as small as possible.

* * * * *

(f) *Retroactive adjustment.* (1) Medicare provides that providers of services will be paid amounts determined to be due, but not less often than monthly, with necessary adjustments due to previously made overpayments or underpayments. Interim payments are made on the basis of estimated costs. Actual costs reimbursable to a provider cannot be determined until the cost reports are filed and costs are verified. Therefore, a retroactive adjustment will be made at the end of the reporting period to bring the interim payments made to the provider during the period into agreement with the reimbursable amount payable to the provider for the services furnished to program beneficiaries during that period.

(2) In order to reimburse the provider as quickly as possible, an initial retroactive adjustment will be made as soon as the cost report is received. For this purpose, the costs will be accepted as reported, unless there are obvious

errors or inconsistencies, subject to later audit. When an audit is made and the final liability of the program is determined, a final adjustment will be made.

(3) To determine the retroactive adjustment, the amount of the provider's total allowable cost apportioned to the program for the reporting year is computed. This is the total amount of reimbursement the provider is due to receive from the program and the beneficiaries for covered services furnished during the reporting period. The total of the interim payments made by the program in the reporting year and the deductibles and coinsurance amounts receivable from beneficiaries is computed. The difference between the reimbursement due and the payments made is the amount of the retroactive adjustment.

(9)

No. 87-1097

In the Supreme Court of the United States

OCTOBER TERM, 1988

OTIS R. BOWEN, SECRETARY OF HEALTH AND HUMAN SERVICES, PETITIONER

v.

GEORGETOWN UNIVERSITY HOSPITAL, ET AL.

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE DISTRICT OF COLUMBIA CIRCUIT

REPLY BRIEF FOR THE PETITIONER

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TABLE OF AUTHORITIES

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In their brief, respondents have given little more than lipservice to the principal ground relied upon by the court of appeals in invalidating the Secretary's curative retroactive cost limit rule – that the APA bars the promulgation of retroactive rules. They instead base their claim of invalidity primarily on two alternative grounds: (1) a sweeping assertion (Br. 22) that curative rulemaking is "an affront to the integrity of the administrative process"; and (2) a narrower argument that the Medicare Act itself bars the promulgation of a retroactive cost limit rule even where, as in this case, it is merely curative in character.

As we explained in our opening brief, however, there is nothing inherently suspect or improper about curative lawmaking. A curative rule avoids the element of unfair surprise associated with other forms of retroactive lawmaking. And if curative rulemaking were not possible, mere procedural errors by administrative agencies could be parlayed into interim victories on the merits, conferring an unjustified economic windfall on those seeking federal reimbursement. Far from being the

"affront" claimed by respondents, therefore, curative rulemaking protects legitimate claims of entitlement and keeps the administrative process focussed on the substantive aspects of a regulatory program.

There is likewise no merit to respondents' narrower claim that the Medicare Act bars the Secretary's retroactive cost limit rule challenged in this case. As explained in our opening brief, that rule may be sustained as a valid exercise of the Secretary's general rulemaking authority under the Act, and it was also independently authorized by Section 1861(v)(1)(A)(ii) (Clause (ii)) of the Act. Contrary to repsondents' claim, the statutory language of Section 223(b) provides no support for their contention that cost limit rules must always be prospective. And the legislative history upon which respondents rely—one sentence reproduced in two legislative reports—does not purport to address the propriety of a retroactive rule, such as the one at issue here, that is merely curative in character.

Respondents' attempted refutation of the Secretary's construction of Clause (ii) also fails. Clause (ii) need not "override" Section 223(b) in order to authorize the Secretary to promulgate a retroactive cost limit rule. Indeed, as explained in our opening brief, Clause (ii) empowers the Secretary to promulgate a retroactive cost limit rule precisely because Section 223(b) authorizes the Secretary to utilize cost limit rules as a method for determining a provider's level of reimbursement. A scheme for "retroactive corrective adjustments" through rules of general application is a sensible, indeed necessary, complement of Congress's decision to authorize cost limit rules.

1. Respondents repeat (Br. 19-22) the basic rationale of the court of appeals' ruling that the APA bars the promulgation of retroactive rules, but they do not seriously defend it. Indeed, respondents, by agreeing that retroactive rules are permissible in certain circumstances,[1] but suggesting no way in which that

[1] Respondents admit (Br. 19) that the APA does not restrict rules of "secondary retroactive effect" (rules that apply to ongoing activities that commenced prior to the rule's effective date) and, more importantly, they also admit (Br. 20 n.22) that the APA permits rules of "primary retroactive effect" in certain circumstances. According to respondents (*ibid.*), the latter type of retroactive rule is permissible under the APA in "[e]xtraordinary circumstances" or where "unavoidable" or "necessary," but only so long as "special care" is taken to ensure that "interested parties are not unduly harmed."

result can be squared with the court of appeals' analysis of the statutory language, have effectively conceded that the court of appeals' ruling is incorrect. If, as the court of appeals held (Pet. App. 13a), the APA's requirement that rules have "future effect" (see 5 U.S.C. 551(4)) pertains to *what* transactions a rule applies (*i.e.*, past or future), rather than merely to *when* a rule applies (*i.e.*, is legally effective), then there is no room under the APA for even those limited exceptions admitted by respondents.

As explained in our opening brief (at 21-25), we believe that the APA's "future effect" requirement refers simply to when a rule applies, *i.e.*, to when it is legally effective. The APA imposes no limitation on an agency's decision to apply a rule retroactively, *i.e.*, to a transaction that occurred in the past, except, of course, that such a decision is subject to judicial review under the APA's "arbitrary and capricious" standard (5 U.S.C. 706(2)(A)). Not surprisingly, respondents point to nothing in the APA's statutory language or legislative history to support the more exacting standard of judicial review that they propose to apply to such rules (see note 1, *supra*), which is merely a legal standard of their own invention.

Nor do respondents or any of their supporting amici undermine our showing that the APA's legislative history is consistent with the longstanding view—shared by courts and commentators alike—that agencies may promulgate retroactive rules (see Pet. Br. 21-23, 25-34). The statements in the reports and debates and in the *Attorney General's Manual on the Administrative Procedure Act* (1947) [hereinafter *Attorney General's Manual*] relied upon by respondents (Br. 20-21 & nn. 24, 25) and their amici (see Amer. Hosp. Ass'n (AHA) Amicus Br. 7-8) are, at best, inconclusive. For instance, Representative Gwynne's statement that " 'rules or regulations which have the effect of law must * * * go into effect at some future date,' "

quoted by respondents (Br. 20 n.24 (quoting Senate Comm. on the Judiciary, 79th Cong., 2d Sess., *Administrative Procedure Act—Legislative History* 374 (1946) [hereinafter *APA Leg. Hist.*]), actually supports our view that "future effect" refers merely to the legal effectiveness of the rule (*i.e.*, when a rule applies). The other cited references to "future effect," "future law," and "future conduct" likewise do not purport to answer the retroactivity question posed here. They are instead consistent with our view that a rule may be legally effective in the future, yet once effective, may govern transactions in the past. None of those comments suggests that a rule can apply only to "future conduct."

In fact, in passages acknowledged by respondents (Br. 21-22), Congress directly addressed the retroactivity issue only once in the legislative history. That reference, together with a directly relevant comment in the *Attorney General's Manual,* fully supports our view (see Pet. Br. 30-33). The former draws the very distinction we do between a rule's legal effectiveness and its applicability to past conduct. See H.R. Rep. 1980, 79th Cong., 2d Sess. 49 n.1 (1946), *reprinted in APA Leg. Hist.* 283 n.1) ("The phrase 'future effect' does not preclude agencies from considering and, so far as legally authorized, dealing with past transactions in prescribing rules for the future."). And the latter affirmatively denies that retroactive rules are barred. See *Attorney General's Manual* 37 ("Nothing in the Act precludes the issuance of retroactive rules when otherwise legal * * *."). Unlike respondents (Br. 22), we do not believe that the *Attorney General's Manual* erred by "using the term 'retroactive rules' loosely." Its message is unambiguous.[2]

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[2] There is likewise no merit to amicus AHA's effort (AHA Br. 10) to discount Congress's omission from the APA of proposed language that would have explicitly prohibited retroactive rules. It is well settled that such legislative history can be a weighty indicator of congressional intent. See *Schwegmann Bros.* v. *Calvert Distillers Corp.*, 341 U.S. 384, 391-392 (1951) ("In view of this history we can only conclude that, if the draftsman intended that the nonsigning retailer was to be coerced, it was strange indeed that he omitted the one clear provision that would have accomplished that result."); *Wright* v. *Vinton Branch*, 300 U.S. 440, 458 n.2, 459 n.4 (1937); *Federal Trade Comm'n* v. *Raladam Co.*, 283 U.S. 643, 648 (1931). Contrary to amicus AHA's suggestion (Br. 10 n.6), moreover, we do not contend that Congress's failure to adopt an introduced bill is, by itself, weighty evidence that Congress rejected the substance of the bill (or even considered it). Rather, the legislative history upon which we rely is weighty because, as described in our opening brief (at 25-29), it shows that *in enacting* the APA Congress actually considered and rejected proposed language that would have explicitly accomplished the very ban on retroactive rules that amicus AHA nonetheless claims that Congress intended to impose.

2. Although respondents largely retreat from the substance of the court of appeals' APA ruling, they zealously embrace that court's conclusion (Pet. App. 14a) that the Secretary's curative retroactive rule "make[s] a mockery of" administrative procedure. See Resp. Br. 22-38. Respondents' arguments in this connection, however, mischaracterize the district court's decision, confuse (once again) the concepts of legal effectiveness and retroactivity, misapprehend the purpose of the APA's notice and comment requirement, and ignore the very real limitations that the APA's arbitrary and capricious standard imposes on the promulgation of retroactive rules.

a. First, respondents repeatedly mischaracterize the district court's 1983 decision invalidating the Secretary's 1981 rule. As explained in our opening brief (at 15-18), that decision did not order the Secretary to pay respondents in accordance with the Secretary's prior 1979 rule; nor did it deny the Secretary any right subsequently to promulgate a retroactive rule on remand. As its terms make clear (see Pet. App. 64a), the 1983 order simply invalidated the 1981 rule. It did not finally decide the question of the appropriate standard to be applied in calculating the wage cost reimbursement owed to respondents under the Medicare program. Indeed, the district court specifically refused to issue an order barring the Secretary from applying the 1981 rule to respondents' reimbursement claims, holding that the provisions of the Medicare statute requiring exhaustion of administrative remedies deprived the court of any authority to issue such an order. Hence, the Secretary's decision not to appeal that order did not reinstate the Secretary's prior 1979 rule so as to preclude any subsequent retroactive rulemaking.

Nor do the numerous decisions cited by respondents (Br. 23) support the assertion "that the usual effect of invalidating a rule that purports to repeal an earlier rule is to leave in place the earlier rule" so as to preclude the agency's subsequent promulgation of a retroactive curative rule. In the lone decision of this Court cited by respondents, *United States* v. *Baltimore & O. R.R.*, 284 U.S. 195 (1931), the Court invalidated the administrative agency's order, but did not reinstate a prior agency order. It merely acknowledged the continuing validity of a *private* agreement that was entered into prior to the invalid order (*id.* at 203-204). That result was, moreover, compelled by a statutory provision barring the agency from promulgating any order with retroactive effect (see *id.* at 199).

In addition, although many of the lower court decisions cited by respondents (Br. 23) do hold that the legal effect of a court's invalidation of an agency rule may be to reinstate the agency's prior rule,[3] they do not support respondents' further claim that the necessary effect of reinstatement is to bar the agency from subsequently promulgating a retroactive curative rule. Indeed, the lower courts typically assume that retroactive correction may be possible. See, *e.g.*, *Cumberland Medical Center* v. *Secretary of Health & Human Services*, 781 F.2d 536, 538-539 (6th Cir. 1986); *Menorah Medical Center* v. *Heckler*, 768 F.2d 292, 297 (8th Cir. 1985); see also *Tallahassee Memorial Regional Medical Center* v. *Bowen*, 815 F.2d 1435, 1453 n.35 (11th Cir. 1987), cert. denied, No. 87-380 (Apr. 25, 1988); *Mason Gen. Hosp.* v. *Secretary of Dep't of Health and Human Services*, 809 F.2d 1220, 1223, 1229 (6th Cir. 1987).[4]

[3] The cases upon which respondents (and the court of appeals in this case (Pet. App. 13a)) rely almost invariably cite the D.C. Circuit's statement in *Action on Smoking & Health* v. *CAB*, 713 F.2d 795, 797 (1983) that the effect of invalidating an agency rule is to "reinstat[e] the rules previously in force." That statement did not, however, purport to establish an invariant rule of administrative law. The reinstatement of the prior rule was ordered in that case only because the agency had engaged in "repeated technical noncompliance" with the APA (*id.* at 802). In any event, as we explained in our opening brief (at 16-17), respondents' contrary view advances an unworkable principle of administrative law that would improperly permit courts to usurp agency responsibility for the implementation of federal statutes and could have the effect of reinstating a prior rule that has already been found unsatisfactory. For this reason, it would prompt agencies to seek review of many more lower court decisions invalidating agency rules based on procedural defects.

b. Respondents argue (Br. 27-35) that a retroactive curative rule is impermissible where, as in this case, the initial legal error committed—violation of the APA's notice and comment requirement—"is one that by its very nature cannot be corrected retroactively" (Br. 27). Indeed, respondents assert (Br. 28) that if an agency's first effort is judicially invalidated on procedural grounds, the agency "can make the change in policy effective thirty days after it has completed the required prerequisites, but it cannot make the change retroactive to the date that it originally intended." Respondents accordingly argue (*ibid.*) that because the Secretary had to comply with the APA's procedural requirements, including notice and comment, "by June 1, 1981 (thirty days in advance) for the rule to be effective on July 1, 1981, it is axiomatic that the agency could not cure the 'legal error' by undertaking the steps in 1984."

Respondents forget, however, that a rule may be effective in the future, yet, once effective, may concern transactions that were completed prior to its effective date. In this case, for example, the effective date of the Secretary's 1984 retroactive rule was 30 days *after* its promulgation. See 49 Fed. Reg. 46495 (1984); J.A. 29. The rule did not purport to have an effective date of July 1, 1981.[5] Hence, contrary to respondents' claim,

[4] Respondents' effort to distinguish *SEC* v. *Chenery Corp.*, 332 U.S. 194 (1947) is unpersuasive. Although *Chenery*, unlike this case, involved an adjudicative order, the principle of administrative law it established—that "[t]he fact that the Commission had committed a legal error in its first disposition of the case certainly gave [the respondents] no vested right" (*id.* at 200-201)—applies with even greater force to the rulemaking setting. Nor can a valid distinction be drawn based on differences between the legal error committed by the agency in the two cases. In both cases, the agency committed a legal error that did not mean that the substance of the rule was also invalid.

[5] For this reason (and others), the reasoning of respondents' hypothetical based on Agencies A, B, and C, is likewise flawed. Contrary to respondents' claim (Br. 30), the Secretary here did not, like Agency C in respondents' hypothetical, republish its rule in 1984 "after following notice and comment procedures, and once again [make] the rule effective July 1, 1981."

the 1984 rule did satisfy the APA's procedural requirements, including notice and comment, at least 30 days prior to its effective date.[6]

Respondents also wrongly assume that the purpose of the notice and comment requirement is to afford those whose activities are covered by the proposed regulation an opportunity to modify their conduct prior to the final regulation's effective date. The notice and comment procedure serves an important, yet distinct, function. It informs the public, including potentially affected parties, of the substance of the proposed rule and thus provides those interested with an opportunity to comment on the rule's substance prior to its formally becoming law.[7] To be sure, the notice requirement also makes it possible for affected parties to adjust their conduct before the effective date—and thus to limit the potential impact of the regulation—but it does not mean that the regulation, once effective, may apply only to conduct occurring in the future.[8]

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[6] For this reason, respondents' statute of limitations analogy also fails (Resp. Br. 28).

[7] The public receives notice on at least two occasions: when the proposed regulation is published in the Federal Register and when the final regulation is published, which must be at least 30 days before the regulation's effective date, except in specified circumstances (see 5 U.S.C. 553(d); Pet. Br. 25 n.15).

[8] Respondents nonetheless argue (Br. 36 & n.40) that they have been harmed because notice and comment occurred after their costs were incurred and, consequently, they were not able to adjust their behavior during the delay that typically occurs between the time a rule is first proposed and the time that it is formally made final and effective. By respondents' own account (Br. 35), however, it is quite unlikely that they would have made any such adjustment, because they "operate under established labor and supply contracts that generally cannot be terminated at will." Indeed, for this reason, respondents argue that they should be entitled to a "one or two year grace period[]" (*ibid.* (emphasis deleted)). The APA, however, confers no such statutory right on respondents. In any event, respondents' claim of prejudice is relevant only to the question whether the Secretary's decision to impose this particular curative rule retroactively was arbitrary and capricious, a question we address in our opening brief (at 36-40). It does not provide a ground for invalidating all retroactive curative rules.

c. Respondents next attack the Secretary's curative retroactive rule by arguing (Br. 30-31) that if curative rulemaking is allowed there is no reason why "any agency that wants to make a rule effective immediately [would] bother to comply with APA public participation procedures in the future." Contrary to respondents' claim, however, an agency that wants to achieve a substantive change in an administrative rule has (as it should be) every incentive to comply fully with the APA, regardless of the availability of curative rulemaking.

By complying with APA procedural requirements in the first instance, an agency can promulgate a rule with an early effective date and thus avoid any need for a curative retroactive rule. By contrast, if an agency complies with the APA only after having its initial rule invalidated on procedural grounds, it will necessarily promulgate a rule with a much later effective date. Hence, its initial noncompliance means that the rule will have to be retroactive just to cover the time period that would have been covered without retroactive effect had the agency simply complied in the first place.

Moreover, respondents ignore that a curative retroactive rule is subject to judicial review. In determining whether an agency's decision to impose a curative rule retroactively is arbitrary and capricious, a court will clearly not be disposed in the agency's favor if it perceives (as posited by respondents) that the agency has deliberately violated the APA's procedural requirements in a calculated effort to lay the foundation for a subsequent claim that any retroactivity was merely curative in nature.[9] Because, moreover, public comment on the proposed change might require a substantive modification of the proposed rule, the agency cannot assume that it will be able to rely heavily on the merely curative character of its final rule to justify the rule's retroactive impact.

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[9] There is no evidence in this case to suggest that the Secretary acted other than in good faith in promulgating both the 1981 cost limit rule and the 1984 retroactive rule. Indeed, the Secretary can hardly be accused of bad faith given his decision to comply with APA notice and comment requirements in promulgating provider reimbursement regulations under the Medicare Act, notwithstanding the exemption from those requirements under the APA for public property, loans, grants, benefits, or contracts (see Pet. Br. 6 n.3).

d. Respondents and amicus AHA also argue (Resp. Br. 32; AHA Amicus Br. 21) that curative rulemaking should be barred because, they suggest, it is difficult to persuade an agency on judicial remand to change the substance of a rule that has been invalidated on procedural grounds. These speculations, however, are not grounded in concerns that are unique to, or even disproportionately associated with, curative retroactive rules. Precisely the same concerns exist if, following judicial remand, the agency promulgates a rule that is only prospective in effect. In either circumstance, the agency has previously announced what it believes the rule of law should be. Whether the rule is both retroactive and prospective or merely prospective is wholly incidental to the substance of the rule.

Here again, respondents ignore the important safeguards provided by judicial review. As we explained in our opening brief (at 20-21), an agency is required on remand to consider any information obtained during further notice-and-comment proceedings and to respond to significant comments made. The agency may be persuaded by those comments to change the substance of the rule, or a court may set aside the agency's action if it acts arbitrarily and capriciously in failing to modify the rule in response to comments (see 5 U.S.C. 706(2)(A)). But in any event, the possibility that some agencies might fail to comply in good faith with APA procedural requirements following judicial remand does not support respondents' extravagant claim (Br. 22) that all curative rulemaking is "an affront to the integrity of the administrative process."[10]

e. Finally, perhaps the greatest flaw in respondents' analysis is their failure to acknowledge that an agency must independently justify its decision to allow a rule to have retroactive effect. Respondents repeatedly claim (Br. 30-31; see also *id.* at 27-30) that under our view an agency can violate the APA's procedural requirement yet "easily achieve its original purpose by simply pursuing retroactive rulemaking." As we ex-

[10] Respondents' baseless accusation (Br. 34 n.38), repeated by amicus AHA (Br. 18-21), that the Secretary has engaged in "outright abuse of the judicial system" concerns matters far afield from this case and, in any event, merits no response.

plained in our opening brief (at 36-40), however, we are not suggesting that an agency's decision to promulgate a retroactive rule, including a rule that is curative in nature, is automatically valid. The decision to apply a rule retroactively is subject to judicial review under the arbitrary and capricious standard. To apply that standard, a court must determine whether "the mischief of producing a result which is contrary to a statutory design or to legal or equitable principles * * * is greater than the ill effect of the retroactive application of a new standard." *SEC* v. *Chenery Corp.*, 332 U.S. 194, 203 (1947); see Pet. Br. 37.[11] For the reasons described in our opening brief (at 36-40), and below (pages 15-17, *infra*), the Secretary's decision to apply its 1984 cost limit rule retroactively was not arbitrary and capricious.

3. The gravamen of respondents' more focussed attack on the Secretary's 1984 retroactive cost limit rule is the contention that retroactive cost limit rules are specifically barred by Section 223(b) of the Social Security Amendments of 1972, Pub. L. No. 92-603, 86 Stat. 1393. Section 223(b) amended Section 1861(v)(1)(A) to allow the Secretary to promulgate cost limit rules on a presumptive and class-wide basis (see Pet. Br. 34 & n.26). According to respondents (Br. 10-13, 14-15, 18-19), this amendment deprives the Secretary of any authority to apply the 1984 rule retroactively either pursuant to his general rulemaking authority under the Medicare Act (see 42 U.S.C. (& Supp. III) 1395x(v)(1)(A), 1395hh, 1395ii) or pursuant to his authority

[11] Hence, respondents are wrong in asserting (Br. 31 n.34) that the "logical consequences of the Secretary's position" is that, following this Court's invalidation in *Morton* v. *Ruiz*, 415 U.S. 199 (1974), of a rule promulgated by the Bureau of Indian Affairs (BIA), the BIA was "free to reinstate the [prior rule] retroactively by a 'curative' publication * * * and then proceed to recoup from [the individual] the amounts he received as a result of this Court's decision." The Court invalidated the BIA's rule on both procedural and substantive grounds and, consequently, the BIA obviously could not simply repromulgate the same rule as before after complying with the procedural requirements previously violated. In addition, even if the BIA's initial error had been only procedural in character and the BIA had subsequently sought to promulgate a retroactive rule, it is far from certain that the agency's decision would not have been deemed arbitrary and capricious. Significantly, the individual affected by the BIA's rule in *Morton* v. *Ruiz*, unlike respondents in this case (see Pet. Br. 38-39), had not received any formal notice of the substance of the agency's rule prior to its application to him (see 415 U.S. at 234-236).

under Clause (ii) to issue regulations that "provide for the making of suitable retroactive corrective adjustments". Although respondents argue that their proffered construction is supported by the statutory language[12] and the Secretary's prior administrative construction of Section 223(b),[13] the only significant evidence they muster in support of their view is a single sentence, reproduced in two legislative reports. See H.R. Rep. 92-231, 92d Cong., 1st Sess. 83 (1971) ("[The] authority to set limits on costs recognized for certain classes of providers * * * would be exercised on a prospective, rather than a retrospective, basis so that the provider would know in advance the limits to Government recognition of incurred costs and have the opportunity to act to avoid having costs that are not reimbursable."); S. Rep. 92-1230, 92d Cong., 2d Sess. 188 (1972) (same). As we explained in our opening brief (at 35), however, those statements focus only on the Secretary's authority to promulgate cost limit rules in the first instance. They do not purport to speak to the distinct question raised in this case, which is whether the Secretary has authority, following judicial invalidation of a wholly prospective rule on procedural grounds, to promulgate a new rule on remand that applies to the same period

[12] Respondents argue (Br. 10 (emphasis in original)) that Section 223(b)'s language expressly "requires the Secretary to establish the limits *before* the beginning of the period to which they apply," because it states that the Secretary's regulations "may provide for the establishment of limits on the direct or indirect overall incurred costs * * * *to be recognized* as reasonable * * *" (42 U.S.C. (& Supp. III) 1395x(v)(1)(A) (emphasis added)). We have already explained in our opening brief (at 34 n.25), however, that the phrase "to be recognized" simply reflects that, by their very nature, *re*imbursement determinations (when costs are "recognized") occur after costs have been incurred.

[13] As we explained in our opening brief (at 35 & n.27), respondents' reliance on previous occasions where the Secretary has commented on the prospective effect of particular cost limit rules is misplaced. On none of those occasions did the Secretary intimate that a curative cost limit rule could not be retroactive. For example, in the decision of the Deputy Administrator of the Health Care Financing Administration in *Beth Israel Hosp.* v. *Blue Cross Ass'n*, Medicare and Medicaid Guide (CCH) ¶ 31,645 (reproduced at J.A. 64-75), upon which respondents rely (Br. 12), the Secretary's delegate refers only to the Secretary's "*general policy* to apply cost limits prospectively" (J.A. 69 (emphasis added)).

that would have been covered by the invalidated rule. As further explained in our opening brief (at 35-36), moreover, very different considerations apply in the present circumstances, particularly because the substance of the 1984 rule is identical to the prospective rule promulgated in 1981.[14]

4. Respondents' grounds for resisting the Secretary's construction of Clause (ii) are equally unpersuasive. The Secretary's construction of Clause (ii) is neither inconsistent with the statutory languge (see Resp. Br. 15-16) nor contrary to the Secretary's view of the provision soon after its enactment (*id.* at 17-18).[15]

First, as we explained at length in our opening brief (at 43-44), the language of Clause (ii) can be rationally construed as authorizing the Secretary to issue a retroactive regulation of general application where, as in this case, the application of a prior cost reimbursement regulation has resulted in systemically excessive or inadequate reimbursement. The terms "adjustments," "a provider of services," and "aggregate reimbursement" are not to the contrary. An erroneous cost limit rule can, as in this case, produce "aggregate reimbursement" that is "inadequate or excessive" for "a provider of services" and others similarly situated and an "adjustment" can be made to "correct"

[14] Respondents argue (Br. 13 n.11) that the Secretary cannot rely on the 1981 rule as supplying them with advance notice because that rule was held invalid. As we explained in our opening brief (at 38-39), however, respondents incurred of all their rel. ant costs prior to judicial invalidation of the 1981 rule, and although they were of course then free to hope that the rule would subsequently be invalidated on procedural grounds (as they likely still hope that the new rule will be invalidated on substantive grounds should their current challenge fail), they cannot claim, in effect, an entitlement to that result based on their own unilaterally-created expectations. Respondents offer no precedential support for their novel theory that they were entitled to ignore the 1981 rule because they thought it was "patently invalid" at the time (Br. 13 n.11, 36 n.41)).

[15] We have already explained in our opening brief (at 40-41 n.34) why respondents' threshold contention (Br. 13-14) that the Secretary cannot now rely on Clause (ii) because he never relied on it during the rulemaking proceedings is incorrect.

the error by a retroactive rule. The other words emphasized by respondents (Br. 15), including "particular provider[]" and "particular period," appear nowhere in Clause (ii).

Indeed, the statutory language supports the Secretary's reading of the provision. The literal terms of Clause (ii) provide that cost limit regulations shall themselves provide for "suitable retroactive corrective adjustments."[16] They also direct the Secretary to focus on the "method" that prompted the reimbursement error requiring corrective action. As we explained in our opening brief (at 46-47), where, as in this case, the "method" that prompted the intitial error was a cost limit rule, the error is often best redressed by changes in the rules themselves, and only retroactive application of those changes will achieve the required "adjustment" in the prior erroneous reimbursement award.

Although the legislative history is silent on the question,[17] the Secretary's reading is also supported by the historical development of the Medicare law. As we explained in our opening brief (at 44-45, 46-47), Clause (ii)'s meaning has not been static since its original adoption in 1965. It is one subsection within a larger provision governing Medicare reimbursement and, by its very wording, derives its full meaning from the contents of the entire provision. Hence, as that provision has undergone amendment—for instance with the passage of Section 223(b) in 1972—the scope and meaning of Clause (ii) has correspondingly

[16] Clause (ii) begins with the phrase "[s]uch regulations," which logically includes cost limit rules (see Pet. Br. 44).

[17] Respondents wrongly assert (Br. 18 n.18) that "[t]he Secretary's discussion of the legislative history is contradictory." Our statement that the legislative history of Section 223(b) does not discuss Clause (ii) or its relationship to the Secretary's authority to promulgate cost limit rules does not "contradict[]" our earlier acknowledgement that, prior to Section 223(b), "excessive costs could be disallowed only on a case-by-case basis" (Pet. Br. 35). The latter statement did not address the meaning of Clause (ii) following congressional passage of Section 223(b)—which is the issue raised in this case. Indeed, the quoted statement does not speak at all to the meaning of Clause (ii) at any time or even refer to any legislative history concerning that statutory provision. It merely describes in general terms the Medicare reimbursement scheme prior to the addition of Section 223(b) in 1972.

evolved. A scheme for "retroactive corrective adjustments" through cost limit rules of general application is a sensible, if not necessary, complement to Congress's authorization of class-wide cost limit rules.

For this reason, moreover, respondents' reliance on any statements purporting to construe the scope of Clause (ii) prior to 1972 is misplaced (see Resp. Br. 17), as is respondents' related contention that the Secretary's current construction is not entitled to deference on that account (*id.* at 18-19). In any event, the testimony of a government official quoted by respondents (*id.* at 17 & n.16) does not show that the Secretary's current construction of [Clause (ii)] "conflicts with the construction adopted by the agency near the time of the provision's enactment." A curative retroactive cost limit rule that achieves "suitable retroactive corrective adjustments" does not " 'retroactively change the principles' " (*ibid.* (quoting *Reimbursement Guidelines for Medicare: Hearings Before the Senate Comm. on Finance,* 89th Cong., 2d Sess. 56 (1966) (emphasis deleted) (testimony of Robert M. Ball, Commissioner of Social Security Administration)). Such a rule simply ensures that the "principles" are maintained by redressing errors in their implementation. In this case, for instance, respondents incurred all of their relevant costs after the Secretary's 1981 regulation was promulgated and before it was invalidated on procedural grounds.[18]

5. Finally, respondents' assertion (Br. 38-50) that the Secretary's decision to promulgate a retroactive rule was itself arbitrary and capricious is unpersuasive for two reasons. First, respondents' description (*id.* at 38-40) of the "ill effects" of retroactivity rests on mischaracterizations of the impact of the 1984 rule. Second, their argument that the rule does not serve "any statutory interest" (*id.* at 40-50) is mistakenly directed to

[18] The testimony upon which respondents rely does not, moreover, even clearly concern Clause (ii). The then-Commissioner of the Social Security Administration never specifically refers to Clause (ii) in the excerpts quoted and we believe that he was more likely referring to an entirely different provision, 42 U.S.C. (Supp. I 1965) 1395g, which authorized a year-end settling of accounts, rather than to Clause (ii).

the substantive validity of the rule, which is not now at issue before the Court.

a. Respondents assert (Br. 39; see *id.* at 24, 34-35) that the Secretary's 1984 retroactive cost limit rule is unjust because it seeks "to recoup monies previously paid by the agency as a result of final court judgment." Contrary to respondents' intimation, however, no monies were paid to them pursuant to a court order, which, as discussed above (see page 5, *supra*), did not order reimbursement under the prior 1979 rule. Respondents were instead paid pursuant to the Medicare cost reimbursement procedures, which were not the subject of the district court's order. Those payments, moreover, were expressly made subject to reopening and recoupment in the event of an adjustment in the amount of reimbursement as the result of the adoption of a new wage cost regulation. See, *e.g.*, Letter from R.M. Hugney to Robert B. Johnson (Jan. 31, 1984) (App., *infra*, 5a); 42 C.F.R. 405.1885.

Nor are respondents correct in characterizing the rule as having "the effect of rewarding the Secretary for his illegal conduct" (Br. 40). In 1983, the district court invalidated the Secretary's 1981 rule on procedural grounds and, rather than appeal that ruling, the Secretary chose to correct the error by promulgating a new rule in accordance with the district court's decision. The Secretary is thus in no manner "reward[ed]" by his 1984 rule.

By contrast, an economic windfall is precisely what respondents obtained in the court of appeals and what they now, in effect, ask this Court to preserve. As we explained in our opening brief (at 15-18, 36-40), respondents seek to convert a purely procedural victory into a substantive victory on the merits that entitles them, in contravention of Congress's mandate, to reimbursement for costs inefficiently incurred.[19] The

[19] Respondents wrongly claim (Br. 29) that we believe "procedural" errors are "insignificant." Our point is simply that the options before an agency are different where, as in this case, the court invalidates a rule based on procedural error, as opposed to where an invalidation is based on a substantive defect in the rule. In the case of a procedural error, the agency may correct the error by complying with applicable procedures that may, or may not, prompt a substantive change in the regulation at issue. Where, however, the error is substantive in nature, the agency can, of course, correct its error only by modifying the substance of its prior rule.

district court's 1983 ruling entitled them, however, only to certain notice and comment procedures—which they have since received—and not to any particular substantive result.

b. Respondents and their supporting amici also attack (Br. 40-50; Sisters of Mercy Health Corp. Amicus Br. 17-25) the Secretary's rule on the ground that it serves no "statutory interest." As respondents concede (Br. 38 n.43), however, the gravamen of their argument is that the substance of the rule is arbitrary and capricious, regardless of any retroactive effect. Neither the district court nor the court of appeals addressed that question, however, and for the reasons outlined in our opening brief (at 37 n.29, 38 n.30), this Court should not consider it in the first instance either.[20]

[20] Contrary to respondents' assertion (Br. 38 n.43) the Secretary is not "ask[ing] this Court to determine that the [1984] rule is not arbitrary and capricious." We expressly stated (Pet. Br. 37 n.28) that the substantive validity of the rule should not be decided. The only issue we discussed was whether the decision to impose the rule *retroactively* was arbitrary and capricious (see *id.* at 36). We do not maintain that the Court must address that issue now, but only that if the Court addresses the issue, it should do so based on the assumption that the rule is substantively valid because neither of the lower courts held to the contrary (see Pet. Br. 38 n.30). In any event, it is clear that the 1984 wage index rule created a more accurate wage index by excluding federal hospital wage data and, hence, it serves the Medicare Act's requirement that the Secretary pay only those costs "necessary in the efficient delivery of needed health services" (42 U.S.C. (Supp. III) 1395x(v)(1)(A)).

For the foregoing reasons, and the reasons stated in our opening brief, the judgment of the court of appeals should be reversed.

Respectfully submitted.

DONALD B. AYER*
Acting Solicitor General

JULY 1988

* The Solicitor General is disqualified in this case.

APPENDIX

MEDICARE
Group Hospitalization, Inc.
serves as intermediary for
Medicare Part A in the
Washington, D.C.
metropolitan area

Group Hospitalization, Inc.
550 12th Street, S.W.
Washington, D.C. 20024
202/479-8000

January 31, 1984

Mr. Robert B. Johnson
Executive Director
D.C. General Hospital
19th & Massachusetts Avenue, S.E.
Washington, D.C. 20003

RE: Notice of Program Reimbursement
Provider No. 09-0007
FYE: September 30, 1982

Dear Mr. Johnson:

We have completed our examination of the Medicare Statement of Reimbursable Cost which you submitted for the period referenced above. In accordance with Medicare Regulation Section 405.1803, Exhibit A (attached) shows our determination of program reimbursement due your facility in comparison to the amount shown on the report which you filed. The adjustments which produce any difference between our determination and your report are shown in the attached audit adjustment report which references applicable Medicare regulations. The Statement of Final Cost Settlement (Exhibit B) includes the tentative settlement and reflects the net amount due the provider/(program).

If additional explanation is needed of the difference between total reimbursement claimed and the amount determined based on our examination, please contact this office. Revision of this notice may be required by the findings of an audit of this or a subsequent cost report.

If the attached Exhibit B indicates a net amount due your facility, our check is enclosed. If there is a net amount due the program, we are hereby requesting payment in full for the amount indicated in brackets. To insure timely receipt of your payment, please forward your check payable to Group Hospitalization, Inc. to the attention of George D. Pitzer, Staff Assistant, Provider Reimbursement Department.

If a lump-sum payment is not possible, you must submit within 15 days from the date of this letter the proposed method of repayment. If the proposed repayment plan is not received and/or approved or a check for the amount indicated in the Statement of Final Cost Settlement (Exhibit B) is not received in 30 days from the date of this letter, a minimum 20% claims payments withholding will be implemented on the 31st day to begin recoupment.

If total recoupment cannot be completed by direct payment from the provider, withholding of claims payments or an extended repayment plan has not been approved, a complete suspension of payments will be imposed 60 days from the date of this letter. Once a withholding or suspension of claims payments is initiated, it must continue to stay in effect until (1) the amount due is paid in full by the provider, (2) the overpayment is eliminated by the claims payment withholding or (3) a repayment plan has been approved by the intermediary or the HCFA Regional Office. In accordance with Section 1866(b)(2)-(A) and (C) of Title XVIII, failure to respond may result in termination of your Medicare participating agreement.

In accordance with Public Law 97-248, interest will be assessed on the amount due the program if payment in full is not received within 30 days of the date of this letter. Interest will be

charged on the unpaid balance and will be calculated for each 30 day period using the following formula:

Principal × Interest Rate = Interest for year
divided by 12 = 30-day interest

For periods of less than 30 days the full monthly interest charge will be applied. (Thus, if payment is received 31 days from the date of this letter, two 30 day periods of interest will be charged). Each payment will be applied first to the accrued interest and then to the principal. After each payment, interest will accrue on the remaining balance at the quarterly rate in effect at the time of this letter. The rate of interest to be charged is based on the current value of funds to the Treasury as issued by the Department of Treasury for the quarter in which this determination was made. This rate will also apply to approved repayment schedules which also must be accompanied by a signed Prommisory Note. The interest rate for determinations from January 1, 1984 through March 31, 1984 is 9.0 percent.

If you are dissatisfied with our determination, and the amount of program reimbursement in controversy is at least $1,000, but less than $10,000, you have a right to a hearing as provided for by Regulation Section 405.1811. You must file a request for a hearing within 180 days from the date of this letter. To be acceptable, such a request must: (1) be in writing, (2) specify the individual adjustment items and amounts to which you take exception, (3) state the reasons supporting your position, and (4) cite the regulation and manual sections upon which you base your exceptions. You may include any additional material you wish to have considered in support of your position.

Request for a hearing must be sent to:

Medicare Provider Appeal's Coordinator
Blue Cross and Blue Shield Association
676 North St. Clair Street
Chicago, Illinois 60611

A copy of your request must be sent to:

Manager
Provider Reimbursement Department
Group Hospitalization, Inc.
550 12th Street, S.W.
Washington, D.C. 20024

If the amount in controversy is $10,000 or more in program reimbursement, you have a right to appeal your dispute to the Provider Reimbursement Review Board established under Public Law 92-603. Instructions for appeal are contained in Regulation No. 5 of the Social Security Administration (20 CFR Part 405) Subpart D, Section 405.1801 – 405.1889. Your request must be directed to:

Paul M. Ganeles
Chairman
Provider Reimbursement Review Board
Room 104
Professional Building
6660 Security Boulevard
Baltimore, Maryland 21207

Copies of your request must be sent to the attention of the Provider Reimbursement Department, Group Hospitalization, Inc. and to Blue Cross and Blue Shield Association as follows:

PRRB Appeals Coordinator
Blue Cross and Blue Shield Association
676 North St. Clair Street
Chicago, Illinois 60611

For information on proper form and required content of an appeal request and for assistance in determining the forum to which your request should be directed, please contact me at (202) 479-8415. In addition, we strongly urge that you discuss with us any problems you may have with the adjustments we have made. Since you have 180 days from the date of this Notice of Program Reimbursement to formally file an appeal request,

there is ample opportunity for discussion without risk of any prejudice to your appeal rights.

The portion of this notice of program reimbursement and accompanying adjustment report which includes federal hospital wage data in the computation of Medicare schedule of limits on hospital per diem inpatient general routine operating cost is subject to modification and revision pursuant to any subsequent notice published in the Federal Register excluding such federal hospital wage data. Consequently, Medicare payments based on the inclusion of federal hospital wage data are subject to recoupment.

Sincerely,

/s/ R. M. HUGNEY
R. M. Hugney
Staff Assistant
Provider Reimbursement

U.S. GOVERNMENT PRINTING OFFICE: 1988—202-037/60571

(11)

No. 87-1097

In the Supreme Court of the United States

OCTOBER TERM, 1988

OTIS R. BOWEN, SECRETARY OF HEALTH AND HUMAN SERVICES, PETITIONER

v.

GEORGETOWN UNIVERSITY HOSPITAL, ET AL.

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE DISTRICT OF COLUMBIA CIRCUIT

SUPPLEMENTAL BRIEF FOR THE PETITIONER

DONALD B. AYER
Acting Solicitor General
Department of Justice
Washington, D.C. 20530
(202) 633-2217

TABLE OF AUTHORITIES

In the Supreme Court of the United States

OCTOBER TERM, 1988

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SUPPLEMENTAL BRIEF FOR THE PETITIONER

This brief is filed pursuant to Rule 35.5 of the Rules of this Court to respond to an amicus brief that was submitted by the Ohio Power Company (OPC) in this case. Our submission of this supplemental brief is contingent on this Court's disposition of OPC's motion for leave to file its brief, which was filed both outside the time allowed by this Court's Rules and after we filed our reply brief, and which OPC acknowledges (Mot. 2) presents arguments that "are not presented in any other brief."[1] It is no mere happen-

[1] Like all other amicus briefs in this case, OPC's brief had to be filed pursuant to Rule 36.2 of the Rules of this Court "within the time allowed for the filing of the brief of the party supported." Hence, because OPC is supporting respondents, its brief was due on June 27, 1988. OPC, however, filed its brief more than five weeks later on August 4, 1988, which was more than one week after our reply brief was due and timely filed with the Court. Contrary to OPC's assertion (Mot. 2), the government did not have under Sup. Ct. R. 35.3 "until a week before argument" to file its reply. Rule 35.3 provides quite clear-

stance, moreover, that neither respondents nor any of their supporting amici presented the arguments now offered by OPC. Not only are OPC's arguments totally lacking in merit but they further underscore the dangers of respondents' position.

1. The thrust of OPC's position is, oddly enough, that the District of Columbia Circuit did not go far enough in this case in banning all retroactive rules. Unlike respondents, which readily acknowledge (Br. 19) that the Administrative Procedure Act (APA) does not restrict rules of "secondary retroactive effect" (rules that apply to ongoing activities that commenced prior to the rule's effective date), OPC argues (Br. 6-7) that the APA's prohibition on retroactivity bars an agency from promulgating a rule that applies to future conduct if that conduct commenced before the rule's promulgation and was not then barred by the agency's prior rule. The only exception from this sweeping prohibition that OPC would admit is where Congress has elsewhere provided advance notice of the possibility of "subsequent regulatory developments," thus defeating "an expectation that the party has rights that may not be disturbed by subsequent administrative proceedings" (*ibid.* (footnote omitted)).

OPC's novel proposition of administrative law is only that: novel. It has never been adopted by this Court or, as far as we can discern from examining the cases cited by OPC, by any other court. In particular, this Court has never held that an agency is always barred from regulating

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ly that "[a] reply brief will be received within 30 days after the filing of the brief for the appellee or respondent, or not later than one week before the date of oral argument, *whichever is earlier,* and only by leave of Court thereafter" (emphasis added). OPC therefore is also wrong in asserting that we would "have ample time to reply to [OPC's] brief" in our reply brief (Mot. 2-3). We can do so only by way of this supplemental brief.

the *future conduct* of a party whenever it has previously approved (or presumably failed to disapprove) of the party's same conduct in the past. The only decision of this Court cited by OPC (Br. 6-7 & n.11, 19-20 n.57) is *United States* v. *Seatrain Lines, Inc.*, 329 U.S. 424 (1947), in which the Court held that the Interstate Commerce Commission (ICC) could not revoke a previously-issued certificate of public convenience and necessity "except as specifically authorized by Congress." But that ruling provides no support for OPC's thesis because it was based on the Court's determination that Congress had denied that very power to the ICC in the Interstate Commerce Act (see *id.* at 430). The Court's holding in no sense announced a generally-applicable principle of administrative law barring retroactive agency lawmaking.

2. OPC's historical evidence for its thesis that the "common law of this nation" supports its proffered construction of the APA is even less persuasive (see OPC Br. 10-14). We do not deny the obvious tensions resulting from the application of a law to past conduct or even, as in OPC's case, to future conduct in a manner that affects past investments. Those tensions, however, are not now and have never been resolved by the application of an unbending principle of common law or natural justice remotely resembling the one invented by OPC, which would effectively bar any law with the slightest retroactive impact. Instead, as the very cases relied upon by OPC demonstrate (see OPC Br. 10-14), those tensions have historically, as they are today, been resolved by the application of familiar, but discrete principles of constitutional law, grounded principally in the Ex Post Facto, Contract, Due Process, and Takings Clauses, and in principles of administrative law barring arbitrary and

capricious action.[2] Contrary to OPC's "historical" evidence, however, the sum of these restrictions and the policies they further within their own discrete areas has not and does not produce a broader overarching common law ban on retroactive laws. See generally Hochman, *The Supreme Court and the Constitutionality of Retroactive Legislation*, 73 Harv. L. Rev. 692, 693-694 (1960) (footnote omitted) ("[T]his natural law theory never attained widespread acceptance in the opinions of the Supreme Court, and it has long been accepted that retroactivity is a ground for holding a statute void only if it contravenes a specific provision of the Constitution."); see also Smith, *Retroactive Laws and Vested Rights*, 6 Texas L. Rev. 409, 411 (1928) ("American authorities denounce retroactivity in the abstract but frequently sustain it in the particular case.").

3. For this reason, moreover, OPC's further contention (Br. 14-18) that the APA "codified" the "common law principle that legislative pronouncements have prospective effect" likewise fails. There was no common law principle barring retroactive legislation to be codified. Instead, as we explained in our opening brief (at 21-23), retroactive rules were generally valid before the APA was enacted, as they are today, so long as their retroactive effect was reasonable and not otherwise barred by law.

Nor is there any merit in OPC's related suggestion (Br. 18-21) that the APA "require[s] that statutory grants of rulemaking authority be construed as authorizing only prospective regulation, absent an explicit statutory authorization to adopt legislative rules affecting past transactions." Certainly, the language in the APA upon

[2] We have, of course, readily acknowledged (Pet. Br. 20-21, 37-38 n.29; Rep. Br. 10) that these discrete principles of constitutional and administrative law may render unlawful certain governmental efforts to impose retroactive laws.

which OPC relies (*id.* at 15 (emphasis in original; footnote omitted))—the words "future effect" in the APA's definition of "rule"—provides no hint that the APA embodies such a canon of construction. OPC, notably, makes no effort to reconcile that canon with its claim that "future effect" amounts to a ban on retroactive rules.

OPC's proposed canon is also not aided by either the Court's decision in *Miller* v. *United States*, 294 U.S. 435, 439 (1935) or what "several Justices observed in *Addison* v. *Holly Hill Fruit Products* [322 U.S. 607 (1944)] shortly before enactment of the APA" (see OPC Br. 18 n.55, 19). *Miller* stands only for the proposition that a regulation will not be read to operate retroactively unless the intention to have that effect unequivocally appears (see 294 U.S. at 439) Here, there is no question that the Secretary's curative rule was intended to apply retroactively. The observations of several Justices in *Addison* are likewise unavailing to OPC, because those views were expressed in dissent. In addition, as we pointed out in our opening brief (at 28-29 n.20), both the majority and dissenting opinions in that case agreed that an agency needs on occasion to promulgate curative retroactive rules, which is the very type of rule challenged in this case (see 322 U.S. at 619, 621; *id.* at 641 (Rutledge, J., dissenting)).

4. Finally, OPC's argument illustrates both the dangers of the District of Columbia Circuit's ruling and why a flat ban on retroactive rules is an unnecessary and inappropriate mechanism for addressing the problems sometimes associated with retroactive lawmaking. For if, as OPC argues, the APA's "future effect" language means that a rule can have no impact on past conduct and not, as we contend, that a rule is legally effective in the future,[3]

[3] OPC argues (Br. 16 n.49) that "future effect" could not refer only to the timing of a rule's legal effectiveness because, given the explicit

then well established, essential agency regulatory activities would become unlawful. Many ongoing activities of regulated entities would be immune from more stringent agency regulation in the future.[4]

Somewhat ironically, the decision of the District of Columbia Circuit that prompted OPC's filing in this case demonstrates precisely why such a total ban on retroactive rules is not necessary to address the harsh consequences sometimes associated with retroactive rules.[5] The court of

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language of Section 4(c) of the Act, "a clarification of this nature would have been unnecessary and hardly worth the special effort an amendment required." As described in our opening brief (at 30-34), however, the APA's legislative history does not support OPC's assumption that Congress intended a major substantive change by adding the words "future effect." It instead suggests that the language was principally added to conform the definition of rule to the operational provisions of the APA, including Section 4(c). The statements in the legislative history upon which OPC relies (Br. 16) do not, moreover, overcome the specific language in both the House Report and the authoritative Attorney's General Manual on the APA that, speaking directly to the retroactivity issue, deny that the APA was intended to proscribe retroactive rules (see Pet. Br. 31-32, 33-34; Rep. Br. 4). Indeed, the House Report, in a passage quoted in our opening brief (at 32), but never acknowledged by OPC, directly refutes OPC's extreme view that the APA's "future effect" language was intended to preclude agencies from "dealing with past transactions in prescribing rules for the future" (H.R. Rep. 1980, 79th Cong., 2d Sess. 49 n.1 (1946)).

[4] For instance, an agency that once required auto manufacturers to include seatbelts would, under OPC's reading of the APA, presumably be prevented by the APA from requiring the same manufacturer to include air bags in the future (*Motor Vehicles Mfrs. Ass'n* v. *State Farm Mut. Auto. Ins. Co.*, 463 U.S. 29 (1983)).

[5] OPC's filing in this case was prompted by the District of Columbia Circuit's decision in *Natural Resources Defense Council* v. *Thomas*, 838 F.2d 1224 (1988), petitions for a writ of certiorari pending, Nos. 87-2068, 88-60 and 88-61. The court of appeals rejected

appeals rejected OPC's claim based on a careful analysis of the competing public and private interests implicated by the EPA's decision not to exempt OPC's future conduct from its rules.[6] All we seek in this case is that the Secretary's retroactive curative rule likewise not be rejected on the basis of an automatic ban and instead be reviewed under the traditional arbitrary and capricious standard.

OPC's contention that that court's construction of the APA in the present case meant that the Environmental Protection Agency (EPA) was precluded from promulgating a rule under the Clean Air Act, 42 U.S.C. 7401 *et seq.*, requiring more stringent reductions of OPC's future emissions at plants that previously had conducted demonstrations conforming entirely to then-applicable EPA rules (838 F.2d at 1243-1244, 1249-1251). We will soon be filing our response to OPC's petition (No. 88-60) in that case, which raises the retroactivity issue, and hence will not address here the merits of that dispute.

[6] OPC mischaracterizes the District of Columbia Circuit's ruling in its amicus brief in this case. Contrary to OPC's intimation (Br. 9), the court of appeals did not find that EPA's rule was outside the APA's general ban on retroactive rules because it "would not affect [OPC's] 'past transactions' " and would "impose only 'future burdens.' " The court instead stressed that EPA's rule was not automatically barred because it regulated only OPC's future *conduct, i.e.*, its "*future emissions*" (838 F.2d at 1244 (emphasis in original)). The court, moreover, freely acknowledged that the regulation of future conduct would impose burdens on OPC because of its prior investment (*ibid.*) and, as described above, the court determined that those burdens did not render EPA's rule an abuse of discretion only after undertaking a careful inquiry into the full panoply of concerns implicated by EPA's decision (*id.* at 1249-1251).

For the foregoing reasons, and those stated in our opening brief and in our reply brief, the judgment of the court of appeals should be reversed.

Respectfully submitted.

DONALD B. AYER
*Acting Solicitor General**

SEPTEMBER 1988

* The Solicitor General is disqualified in this case.

☆ U.S. GOVERNMENT PRINTING OFFICE: 1988—202-037/60841

(12)

No. 87-1097

IN THE

Supreme Court of the United States

OCTOBER TERM, 1988

OTIS R. BOWEN, Secretary of
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Petitioner,

v.

GEORGETOWN UNIVERSITY HOSPITAL, *et al.*,
Respondents.

RESPONDENTS' SUPPLEMENTAL BRIEF

On Writ of Certiorari to the United States Court of Appeals for the District of Columbia Circuit

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Pursuant to Rule 35.5 of the Supreme Court Rules, respondents file this supplemental brief to apprise the Court of "late authorities" not available when respondents filed their brief in chief.

1. In Brief for the Respondents ("Brief") at 16, respondents noted that the interpretation of the retroactive corrective adjustments provision presented in the Secretary's brief must be rejected because, among other things, it is inconsistent with the construction in the Secretary's regulations. A recent decision of the Ninth Circuit invalidating another of the Secretary's Medicare interpretations furnishes additional support for the obvious proposition that an agency's interpretations must be consistent with its regulations. *See National Medical Enterprises v. Bowen*, 851 F.2d 291, 293 (9th Cir. 1988) ("A regulation has the force of law; therefore, an

agency's interpretation of a statute in a manner inconsistent with a regulation will not be enforced.").

2. In their Brief at 34, respondents stated: "To date, all nine courts which have considered the issue have refused to allow the Secretary to apply the 1986 malpractice rule retroactively." Respondents have since learned of a tenth court to rule against the Secretary—*St. Mary's Hospital Center v. Bowen*, CCH Medicare and Medicaid Guide ¶ 37,129 (W.D. Wis. April 26, 1988). Respondents are unaware of any courts that have ruled for the Secretary on this issue, and the Secretary has not identified any such cases.

3. In their Brief at 34 n.38, respondents stated: "The instant case, and the litigation involving the Secretary's 1986 retroactive malpractice rule, are part of a much broader pattern of conduct for which the Secretary has earned a well-deserved reputation for 'hardball' litigation tactics, if not for outright abuse of the judicial system." Further examples of this pattern of conduct will be found in two recent Medicare cases—*PIA-Asheville, Inc. v. Bowen*, 850 F.2d 739 (D.C. Cir. 1988), and *Duggan v. Bowen*, CCH Medicare and Medicaid Guide ¶ 37,220 (D.D.C. Aug. 1, 1988).

At issue in *PIA-Asheville* was whether certain depreciation costs were allowable under the Medicare program. In 1985, the D.C. Circuit had rejected the Secretary's policy disallowing these costs, holding that the Medicare statute required reimbursement. The Secretary nonetheless continued to adhere to his original policy, which he codified in a regulation applied on a prospective basis. In *PIA-Asheville*, the court once again rejected the Secretary's policy. It stated *(per* Judge Lawrence Silberman) that "where the basis for rejection of a policy is its repugnance to the statutory scheme it purports to further, regulatory codification is of utterly no significance" and found "no relevant difference" between *PIA-Asheville* and the court's earlier decision against the Secretary. 850 F.2d at 741-742. "Actually," said the court, "we find it somewhat difficult to understand why the Government filed this appeal." *Id.* at 742 n.4.

In *Duggan*, the court *(per* Judge Stanley Sporkin) invalidated as inconsistent with the plain wording of the Medicare statute a policy of the Secretary that sharply limited the number of home health visits to which Medicare beneficiaries are entitled. Although administrative law judges ("ALJs") and the Appeals Council had consistently rejected the Secretary's policy, the Secretary nonetheless continued to apply it to *all* Medicare beneficiaries, even those who had already obtained numerous final favorable decisions on the issue before ALJs or the Appeals Council. With respect to the Secretary's nonacquiescence policy and the hardship it imposed on individual Medicare beneficiaries, the court stated:

> [T]he actions by HHS in the cases presented to me [have] been reprehensible. It is the most blatant form of stonewalling that an agency can engage in and the Secretary should certainly take all steps to prevent this from happening again.

CCH Medicare and Medicaid Guide ¶ 37,220 at 17,781.

Respectfully submitted,

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(6)

No. 87-1097

In the Supreme Court of the United States

OCTOBER TERM, 1987

OTIS R. BOWEN, SECRETARY OF HEALTH AND HUMAN SERVICES, PETITIONER

v.

GEORGETOWN UNIVERSITY HOSPITAL, ET AL.

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE DISTRICT OF COLUMBIA CIRCUIT

BRIEF OF AMICI CURIAE SISTERS OF MERCY HEALTH CORPORATION AND MICHIGAN HOSPITAL ASSOCIATION

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QUESTIONS PRESENTED

A. Whether the Medicare Act forbids the Secretary of Health and Human Services from issuing a retroactive legislative rule in 1984 which purports to reduce Medicare reimbursement to providers for cost reporting periods of up to three years prior?

B. Whether the Administrative Procedure Act likewise forbids the Secretary from issuing such a retroactive legislative rule?

C. Whether the APA permits the Secretary, after his original prospectively promulgated rule was invalidated because of the failure to comply with the APA's notice and comment procedures, to reissue that identical legislative rule on a retroactive basis to cover the same period that the original unlawful rule would have covered, where the retroactive rule is not integral to fulfilling a statutory purpose?

D. Whether the 1984 retroactive rule satisfies the APA's notice and comment requirements where the Secretary had already determined to issue the rule, and the notice and comment period was a pro forma, post-hoc exercise engaged in simply to satisfy a court's scrutiny, rather than to permit the public to engage in effective, pre-decisional participation in rulemaking?

PARTIES TO THE PROCEEDING AND STATEMENT OF INTEREST

Leila Hospital and Health Center ("Leila") is a division of Sisters of Mercy Health Corporation, a Michigan nonprofit corporation d/b/a Leila Hospital and Health Center. Leila is a community hospital located in Battle Creek, Calhoun County, Michigan. The unlawful retroactive rule of the Secretary ("Secretary") of the United States Department of Health and Human Services ("HHS") will unfairly reduce Leila's Medicare reimbursement by more than $2 Million Dollars.

MHA is a trade association whose members are virtually all of the hospitals in the State of Michigan. The Michigan hospitals are concerned that this Court not adopt positions advocated by the Secretary, which could permit wholesale retroactive changes in the methods of determining Medicare reimbursement.

Both the Secretary, and Respondents have stipulated to the filing of this amici curiae brief. Amici file this Brief in support of Respondents.

The decision below is *Georgetown University Hospital, et al.* v *Bowen*, 821 F.2d 750 (D.C. Cir. 1987). This case is virtually identical to a case now pending before the Sixth Circuit Court of Appeals, *Leila Hospital and Health Center* v. *Bowen*, 661 F.Supp. 394 (W.D. Mich. 1987) and 661 F.Supp. 397 (W.D. Mich. 1987), *appeal docketed*, No. 87-1202, where the district court upheld the validity of the 1984 retroactive Wage Index, as applied to Leila Hospital.

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STATEMENT

This case is one of a series of cases involving a concerted effort by the Secretary to attempt, by issuing retroactive rules, to avoid the consequences of his failure to abide by the Administrative Procedure Act. The retroactive rule issued in this case purports to affect Medicare providers' reimbursement for periods of up to three years prior. If accepted, the Secretary's actions will undermine the integrity of the APA and throw the law of Medicare reimbursement into confusion and create an administrative morass.

The Secretary's pattern of folding layer upon layer of administrative procedure in an attempt to undo his original unlawful acts cannot be sanctioned. Only an unambiguous ruling by this Court will cause the Secretary to cease his cavalier treatment of APA rulemaking requirements.

Section 223(a) of the Social Security Amendments of 1972 amended the definition of reasonable cost for routine services so as to reimburse providers only for "the cost actually incurred, excluding therefrom any part of incurred cost found to be unnecessary in the efficient delivery of needed health services." Social Security Act § 1861x(v)(1)(A); 42 U.S.C.A. § 1395x(v)(1)(A).

In implementing Section 223, the Secretary elected to promulgate regulations setting forth reimbursement limits. The Secretary has calculated the Section 223 limits each year since 1976, 42 C.F.R. § 413.30(a), and then published in the Federal Register the schedule establishing the Section 223 limits for the upcoming year. Under the Section 223 limits, the Secretary reimburses providers the lesser of the provider's allowable costs or the Section 223 limits established for the provider. No hospital provider receives more than its actual costs for medical services. Indeed, the Secretary has never claimed in either this case or in the Sixth Circuit case, *Leila Hospital*, *supra*, that any hospital provider has received more than its costs.

Since 1979, the Secretary has calculated these limits based on labor and non-labor portions. The Secretary has computed

the labor portion using a wage index based on Bureau of Labor Statistics (BLS) data reflecting regional differences in hospital wages. 44 Fed. Reg. 31,806, 807 (1979).

The wage index is equal to the ratio of the average monthly wages of hospital employees for a specific area, usually the Standard Metropolitan Statistical Area ("SMSA"), to the national average monthly wages of hospital employees. The Secretary then multiplies the wage index by a standard base limit for labor costs to obtain the labor cost component of the Section 223 limits for each area.

In calculating the 1979 Wage Index and 1979 schedule of limits, the Secretary included wage data for both federal and non-federal hospital employees in both the regional and national BLS wage figures. The 1980 Wage Index also used the data for all hospital employees and the same general methodology used in the 1979 index. 45 Fed. Reg. 41,868 (1980). In promulgating the 1976-1980 schedules of limits, the Secretary complied with the notice and comment requirements of the APA.

Providers located close to federal hospitals are in direct competition for labor with such hospitals, and cannot effectively compete with these federal hospitals for employees without offering comparable wage and benefit packages. Yet, in 1981, the Secretary purported to issue a rule excluding all federal hospital wage data from the wage index. The 1981 Wage Index thus ignored providers' competition with federal hospitals.

Under the Secretary's 1981 Wage Index rule, Medicare reimbursement would be calculated as if nearby federal hospitals did not exist or did not have an impact on wages. Although some providers could not effectively compete with nearby federal hospitals for employees without offering comparable wages, the 1981 Wage Index ignored this fact, and caused some providers to be under-reimbursed.

The Secretary issued the new 1981 Wage Index without prior notice, without providing for public comments, and with an immediate effective date. 46 Fed. Reg. 33,637 (1981).

Although the Secretary claimed that "good cause" existed for dispensing with APA notice and comment requirements on the theory that the 1981 schedule of limits was developed "by using the same methodology" as in the 1980 schedule of limits, this was obviously false, since, unlike in previous years, federal hospital wage data was now excluded.

The Secretary did acknowledge elsewhere that he had changed the method used to calculate the 1981 Wage Index by "exclud[ing] data from federal government hospitals," 46 Fed. Reg. at 33,639, but the Secretary characterized the change as a "minor technical chang[e]." *Id.* at 33,639.

The Secretary's "minor technical change" resulted in hundreds of thousands of dollars in unreimbursed Medicare costs to hospitals such as Leila.

On April 29, 1983, the United States District Court for the District of Columbia determined in *District of Columbia Hospital Ass'n* v. *Heckler ("DCHA")*, Medicaid and Medicare Guide (CCH) ¶32,871 (D.D.C. April 29, 1983) that the 1981 Wage Index was invalid because the Secretary failed to comply with the notice and comment requirements of the APA, 5 U.S.C. § 553. The *DCHA* court found the Secretary's rationale for failing to comply with the APA's notice and comment requirements "the stuff of which arbitrary and capricious decisions are made." *DCHA*, at p. 9368. The court specifically rejected the Secretary's contention that "good cause" existed for dispensing with required APA notice and comment procedures. The Secretary did not appeal.

The Secretary responded to the invalidation of this rule quickly and methodically. First, the Secretary promulgated a notice announcing the court's decision invalidating the rule. 48 Fed. Reg. 39,998 (1983). Next, on February 17, 1984, the Secretary "reissue[d] for public comment" the methodological change which excluded federal hospital data from the data used to calculate the 1981 Wage Index. 49 Fed. Reg. 6175 (1984). Then, on November 26, 1984, the Secretary issued a final notice (the 1984 Wage Index) reissuing the same 1981 schedule of limits, *on an entirely retroactive basis to cover the same period of time that the 1981 Wage Index rule would*

have covered had it not been invalidated. 49 Fed. Reg. 46,495 (1984). The 1984 Rule was entirely retroactive because it applied only to reporting periods in the past. Thus, after the Secretary improperly issued the 1981 Wage Index rule without notice or comment, and after the *DCHA* court invalidated that rule, the Secretary purported to issue—over two years later—the same rule to cover the same period of time, on an entirely retroactive basis.

SUMMARY OF ARGUMENT

The Secretary's actions cannot stand for several independent reasons. First, the legislative history of the Medicare Act prohibits retroactive application of § 223 cost limit rules, including wage indices, which are components of § 223 cost limits. Express legislative intent shows that cost limit regulations must have prospective effect only. As the court below explained, when Congress passed the amendment authorizing promulgation of § 223 cost limit rules, "both Houses of Congress made clear their intent that this new authority was to be exercised on a prospective basis only." 821 F.2d at 758. Further, the retroactive corrective adjustments provision, 42 USC § 1395x(v)(1)(A)(ii), relied on after-the-fact by the Secretary, does not authorize the Secretary to promulgate general rules of retroactive application, such as the 1984 Wage Index.

Second, the express language and legislative history of the APA demonstrate that retroactive application of legislative rules such as the 1984 Wage Index is not permitted.

Third, the promulgation of a retroactive rule was not permitted because the Secretary was attempting to escape the consequences of his original illegal conduct (issuance of the 1981 Wage Index without complying with the APA) and because the retroactive rule was not essential to fulfill a statutory purpose.

Finally, the Secretary again violated the notice and comment requirements in issuing the 1984 Wage Index. As demonstrated unequivocally below, the Secretary had already made up his mind to issue the 1984 Wage Index, and the notice and

comment afforded was not effective, pre-decisional notice and comment. It was a post-hoc, proforma charade to satisfy a court's scrutiny.

The 1984 Wage Index represents a unique departure from the Secretary's prior course of conduct during the entire period of time in which the Medicare Act has been in effect. The Medicare Act, passed in 1965, requires that the Secretary promulgate numerous regulations defining Medicare reimbursement to providers. The Secretary has always engaged in prospective rulemaking, with only limited departures clearly distinguished in this brief. The 1984 Wage Index constitutes the first (but not last) instance in which the Secretary promulgated a regulation with a lengthy, and exclusive, retroactive effect. Furthermore, the Secretary's 1984 Wage Index rule would retroactively replace an identical rule previously invalidated on the basis that it was arbitrary and capricious. If upheld, the Secretary's actions would undermine the integrity of the rulemaking procedure and violate due process.

The Secretary repeated his administrative abuses in connection with his 1986 rule governing the apportionment of malpractice costs. The Secretary issued the 1986 rule to "cure" his 1979 malpractice rule after a multitude of courts invalidated his 1979 rule and ordered payment under the preexisting rule. All nine courts which have addressed the issue have held sternly and unequivocally that the Secretary may not apply the 1986 malpractice rule retroactively. *See Mason General Hospital* v. *Secretary of Department of Health and Human Services*, 809 F.2d 1220 (6th Cir. 1987); *Tallahassee Memorial Regional Medical Center* v. *Bowen*, 815 F.2d 1435 (11th Cir. 1987); *St. Peter's Medical Center* v. *Heckler*, 813 F.2d 398 (3d Cir. 1987); *Albany General Hospital* v. *Heckler*, 657 F.Supp. 87 (D. Ore. 1987); Miami General Hospital v. *Bowen*, 652 F.Supp. 812 (S.D. Fla. 1986); *West Anaheim Community Hospital* v. *Bowen*, CCH Medicare and Medicaid Guide ¶36,609 (C.D. Cal. July 13, 1987); *St. Joseph's Hospital* v. *Bowen*, CCH Medicare and Medicaid Guide ¶36,437 (D. Ariz. April 15, 1987); *Bethesda Community Hospital* v. *Heckler*, CCH Medicare and Medicaid Guide ¶36,654 (S.D.N.Y. Aug. 5, 1987);

Children's Hospital of San Francisco v. *Bowen*, CCH Medicare and Medicaid Guide ¶36,679 (E.D. Cal. Sep. 3, 1987).

This Court should repeat the stern admonition being given to the Secretary that his flouting of APA requirements will not be tolerated. His apparent philosophy that APA rulemaking requirements are simply so much baggage that can be avoided at will by issuing retroactive rules and engaging in post-hoc, pro forma notice and comment exercises is unacceptable and should not be countenanced.

ARGUMENT

I.

The Medicare Act Prohibits Retroactive Application of The 1984 Wage Index

A. Legislative History And Prior Agency Practice Confirm This Result

Legislation and therefore, *a fortiori*, a regulation, is not given retroactive effect "unless such be 'the unequivocal and inflexible import of the [statutory] terms, and the manifest intention of the legislature.'" *Greene* v. *United States*, 376 U.S. 149, 160, 11 L. Ed. 2d 576, 84 S.Ct. 615 (1964) (quoting *Union Pacific Railroad* v. *Laramie Stock Yards Co.*, 231 U.S. 190, 199, 58 L.Ed. 179, 34 S.Ct. 101 (1913)). *See also Brimstone Railroad and Canal Co.* v. *United States*, 276 U.S. 104,122 (1928) ("The power [of an agency] to require readjustments for the past is drastic. . . . It ought not to be extended so as to permit unreasonably harsh action *without very plain words*.") (Emphasis added.)

There are no "plain words" in the Medicare Act authorizing the Secretary to issue the 1984 Wage Index retroactively. In fact, the plain words show that the power to issue retroactive legislative rules was not granted to the Secretary. Section 223(b) authorizes the Secretary to establish limits on hospital costs "*to be recognized* as reasonable. . . ." (Emphasis added.)

This section requires the Secretary to establish the limits *before* the period begins to which they will apply.

Further, the legislative history of § 223 provides:

> [The authority] to set limits on costs . . . would be exercised on a prospective, rather than retrospective, basis . . . . *Senate Report* at 188; *House Report* at 83, *reprinted in* 1972 U.S. Cong. Code & Admin. News at 5070.

The court below emphasized that "both Houses of Congress made clear their intent that this new authority was to be exercised on a *prospective basis only*." 821 F.2d at 758 (emphasis added). *At the very least*, the power to issue retroactive rules—especially a rule such as the 1984 Wage Index having entirely retroactive effect—is not *conferred* in "unequivocal" or "plain" words. Consequently, the Secretary has no authority to retroactively apply the 1984 Wage Index.

Moreover, the Secretary himself has, until recently, recognized the prospective nature of § 223 cost limit rules, and that the 1984 Wage Index is a § 223 cost limit rule which accordingly is to be applied prospectively. As noted by the court in *Mason, supra:*

> The Secretary's own regulation regarding the limits on cost reimbursements states that "*[p]rior to the beginning of a cost period to which revised limits will be applied*, HCFA [Health Care Financing Administration] will publish a notice in the Federal Register, establishing cost limits and explaining the basis on which they were calculated." 809 F.2d at 1224 (emphasis in original).

The Secretary has consistently identified wage indices as § 223 cost limits to be applied prospectively. *See* 48 Fed. Reg. 39998 (September 2, 1983), 46 Fed. Reg. 48010 (September 30, 1981); and 46 Fed. Reg. 33637 (June 30, 1981). In the proposed notice of rulemaking for the 1984 Wage Index, for example, the Secretary stated in the background section:

> Section 1861(v)(1) of the Social Security Act (42 U.S.C. 1395x(v)(1)) as amended by Section 223 of Pub. L. 92-603, the Social Security Amendments of 1972, authorizes

the Secretary to set *prospective limits* on the costs that are reimbursed under Medicare. 49 Fed. Reg. at 6176 (emphasis added).

Without question, the authority provided to the Secretary by § 223 may be applied prospectively only. Even the Secretary has recognized this in the above public pronouncements, which the Secretary cannot now disavow. The court below aptly commented that "In light of the clear Congressional intent, and the uninterrupted agency practice, *we are astonished that the Secretary now purports to have the authority to promulgate such rules on a retroactive basis.*" 821 F.2d at 759 (emphasis added). By retroactively applying the 1984 Wage Index, the Secretary disrupted the statutory scheme created by Congress. The administrative decision to retroactively apply the 1984 Wage Index when previously the Secretary recognized that wage indices must be prospective is a radical departure from regulations and prior policy, is arbitrary and capricious, and is not permitted by the Medicare Act. The Secretary's action must be invalidated.

B. The Retroactive Corrective Adjustments Provision Does Not Authorize Retroactive Application of the 1984 Wage Index.

The Secretary's reliance on the retroactive corrective adjustments provision, 42 U.S.C. § 1395x(v)(1)(A)(ii),[1] for authorization of the retroactive application of the 1984 Wage Index is untenable. First, the Secretary did not even rely on this provision when he promulgated the 1984 Wage Index but rather issued the rule under § 223, which authorizes *prospective* cost-limit rules. The Secretary's post-hoc attempt to justify the rule under the retroactive corrective adjustments provision is impermissible, given the APA requirements that the Secretary provide notice of proposed rules which contains

[1] 42 U.S.C. § 1395x(v)(1)(A)(ii) provides that the Secretary may "provide for the making of suitable retroactive corrective adjustments where, for a provider of services for any fiscal period, the aggregate reimbursement produced by the methods of determining costs proves to be either inadequate or excessive."

"reference to the legal authority under which the rule is proposed," 5 U.S.C. § 553(b)(2), and that final rules must be accompanied by "a concise general statement of their basis and purpose." 5 U.S.C. § 553(c).

In *Columbus & Southern Ohio Electric Co.* v. *Costle*, 638 F.2d 910 (6th Cir. 1980), the court invalidated an action of the Environmental Protection Agency ("EPA") for "EPA's failure to give a timely rationale." 638 F.2d at 912. The court explained:

> It is rather late in the development of administrative law to argue that an agency may offer *post hoc* bases for a prior decision. The judicial rule barring *post hoc* rationales for agency action applies to (informal) rulemaking as well as to agency adjudication. 638 F.2d at 912.

Moreover, there are numerous other reasons why the retroactive corrective adjustments provision cannot authorize retroactive application of the 1984 Wage Index. First, the legislative history of § 223 expressly provides that cost limit rules must be prospective—not retrospective. Section 223 was enacted subsequently to the enactment of the retroactive corrective adjustments provision. Therefore, whatever power existed under § 1395 to promulgate retroactive cost limit rules applicable across-the-board to all providers was superseded by the express mandate of § 223 that cost limit rules are to be prospective.

Second, the retroactive corrective *adjustments* provision does not authorize the Secretary to promulgate *general rules* of retroactive application such as the 1984 Wage Index. This provision merely empowers the Secretary to make retroactive corrective adjustments in the reimbursement of *particular providers* whose *aggregate* reimbursements are shown to be either "inadequate or excessive." The court in *West Anaheim, supra*, followed the *Georgetown* decision below, and found that the retroactive corrective adjustments provision authorizes "corrections, on an individual basis, but not rules of general application to be applied retroactively." *West Anaheim*, at 5.

The Secretary was not attempting to make a "retroactive corrective adjustment" with respect to the aggregate reimbursement received by "a provider of services," 42 U.S.C. § 1395(v)(1)(A) (ii). Rather, the Secretary was attempting to issue an across-the-board legislative rule applicable to all providers. As such, the 1984 Wage Index rule was not within the scope of § 1395.

Third, the retroactive corrective adjustments provision has never been interpreted to authorize truly retroactive rules, and could not authorize a legislative rule of exclusively retroactive effect such as the 1984 Wage Index. All of the cases which have allowed retroactive application of Medicare rules were cases which involved a regulation predominantly prospective in effect, which provided for recapture of accelerated depreciation. *See, e.g., Tennessee* v. *Califano*, 631 F.2d 89 (6th Cir. 1980); *Fairfax Nursing Center, Inc.* v. *Califano*, 590 F.2d 1297 (4th Cir. 1979); *Adams Nursing Home* v. *Mathews*, 548 F.2d 1077 (1st Cir. 1977); *Springdale Convalescent Center* v. *Mathews*, 545 F.2d 943 (5th Cir. 1977); *Hazelwood Clinic & Convalescent Hospital, Inc.* v. *Weinberger*, 543 F.2d 703 (9th Cir. 1976), *vacated and remanded on other grounds*, 430 U.S. 952, 51 L. Ed. 2d 801, 97 S.Ct. 1595 (1977).

Even the recapture regulation was predominantly *prospective* in nature "because it allowed a provider a six-month grace period after the regulation was promulgated to withdraw from the Medicare program and thereby retain the accelerated depreciation payments made to it." *Mason, supra*, 809 F.2d at 1226. The above recapture cases do not authorize retroactive promulgation of Medicare regulations generally. Only providers who *voluntarily* remained in the Medicare program after the grace period would be subject to the recapture. For this reason, the regulation was held to have "limited and reasonable" retroactive effects. *Hazelwood, supra*, 543 F.2d at 708. However, even this limited retroactive regulation was invalidated in part by the Third Circuit Court of Appeals, in *Daughters of Miriam Center for the Aged*, 590 F.2d 1250 (3d Cir. 1978), which held that retroactive application was beyond the statutory authority of the Secretary to the extent the drop in

utilization was beyond the control of the provider. In such circumstances, the court reasoned that retroactivity is not permissible where the provider did not have an opportunity to voluntarily avoid retroactive application of the regulation.

The court in *Daughters of Miriam* further noted significant congressional intent that the Medicare Act did not authorize the Secretary to promulgate regulations which would retroactively redefine the principles of reimbursement for a cost previously incurred by a provider.[2] In accord with this reasoning, the First Circuit Court of Appeals upheld the limited retroactivity of the recapture regulation as applied to providers who voluntarily terminated participation in the Medicare program, but stated that a regulation which redefined the method for determining the reasonable cost of a purchased item "would be far more troubling. . . ." *Adams Nursing Home* v. *Mathews*, 548 F.2d 1077, 1081 n.12 (1st Cir. 1977).

The 1984 Wage Index does *not* involve such a limited retroactivity or predominantly prospective application. It was intended to have exclusively retroactive application to cost periods already completed, and is not authorized by the Medicare Act. There are no cases which support the Secretary's contention that the retroactive corrective adjustments provision authorizes the entirely retroactive 1984 Wage Index.

In sum, any limited authority for retroactivity which the Secretary may have in *adjudications* under the retroactive corrective *adjustments* provision is irrelevant to the 1984 legislative Wage Index rule.

In addition to procedural invalidity, the 1984 Wage Index suffers from serious substantive defects. Although the *DCHA* trial court did not have cause to reach the substantive merits

[2] "It would hardly seem reasonable at the end of the year, after hospitals had entered into an agreement with you on the basis of certain principles, to shift all principles for retroactive settlement in terms of how you compute a cost. I don't think that was contemplated at all." (Quoting statement of Robert M. Ball, then Commissioner of Social Security). 590 F.2d at 1295, n. 23.

of the 1981 Wage Index, it recognized substantive difficulties. The court commented that the decision to exclude federal hospital data "was clearly a controversial one, and plaintiffs have demonstrated that the Secretary may have been unaware or even mistaken about some facts central to the decision." *DCHA*, at p. 9368. In a footnote to that statement, the court noted that "the defendants did not have a list before them of all federal government hospitals when deciding to exclude their wage data, thus making precise calculation of the fiscal impact difficult." *Id.*, at 9371, n.8. The court added that "defendants may have also erred in their assumption that federal government hospitals 'typically' set their wages according to 'national pay scales.'" *Id.*, at 9371, n.8.

The Secretary has never demonstrated the absence of a relationship between federal hospital and non-federal hospital wages which would justify exclusion of federal hospital data from wage indices. One commentator opined that "eliminating federal hospital wage data from calculation of the wage index will lower reimbursement to facilities located around the federal hospital." 49 Fed. Reg. at 46487. Obviously, a hospital proximately located to a federal government hospital must compete with the federal hospital for employees and should be reimbursed at levels calculated with reference to the wages paid at the federal hospital. Thus, a provider proximately located to a federal government hospital incurs reasonable costs when it competes for labor with that hospital. Yet, the 1984 Wage Index ignores such competition, a clear violation of the reasonable cost standard set forth in 42 U.S.C. § 1395x(v)(1)(A).

Thus, as shown above, the 1984 Wage Index violates the Medicare Act's requirement of *prospective* cost-limit rules, and it must be invalidated. Furthermore, as shown, the 1984 Wage Index rule is substantively flawed.

II.

Retroactive Application of the 1984 Wage Index is Prohibited by the Administrative Procedure Act.

The APA requires an agency promulgating a rule to (1) publish a proposed notice in the federal register, (2) provide an adequate "basis and purpose statement," and (3) invite,

and adequately respond to, public comments on the proposed notice, unless a specific exception to those requirements applies. 5 U.S.C.A. § 553.

In this case, it is uncontested that the Secretary failed to comply with these notice and comment requirements in initially promulgating a change in methodology for the 1981 Wage Index. The Secretary's attempted promulgation *in 1984* of the same 1981 Wage Index, *on a retroactive basis*, finds no support in the APA, and contravenes express language of the APA, past agency practice (see discussion, *supra*), and the Attorney General's own manual on procedure.

First, the APA defines a rule in pertinent part as "the whole or part of an agency statement of general or particular applicability and *future effect* . . . . and includes the approval or prescription *for the future* of rates, wages . . . ." 5 U.S.C. § 551(4) (emphasis added). Moreover, except in specified circumstances, the agency rule may not become effective until 30 days after the date of final publication. 5 U.S.C. § 553(d). Thus, under the express language of the APA, the 1984 Wage Index can have only future effect, not the retroactive effect it purports to have.

The Secretary argues that § 553(d)—which permits a rule to be effective less than 30 days in the future only if there is "good cause"—does not apply when the rule will "take effect" 30 days in the future, but will be entirely retroactive. This is ludicrous, and unsupported by the text of that section. The Secretary's theory is illogical because applying a rule with a lengthy *retroactive* application (which is to "take effect" 30 days in the future) is more onerous and drastic than a *prospective* rule effective less than 30 days after its issuance.

Accordingly, because the 1984 Wage Index is a legislative rule promulgated pursuant to APA rulemaking procedures, the 1984 rule must comply with the APA requirement that rulemaking be prospective. § 5 U.S.C. §§ 551(4), 553(d).

The United States Supreme Court has described the distinction between rulemakings and adjudications in *United States* v. *Florida East Coast Railway Co.*, 410 U.S. 224, 35 L. Ed. 2d 223, 93 S.Ct. 810 (1973):

> While the line dividing them may not always be a bright one, these decisions represent a recognized distinction in administrative law between proceedings for the purpose of promulgating policy-type rules or standards, on the one hand, and proceedings designed to adjudicate disputed facts and particular cases on the other. 410 U.S. at 245.

The court below correctly concluded that the 1984 Wage Index is a legislative rule. The 1984 Wage Index involves a legislative-type policy decision which does not single out a particular party or apply to a particular set of facts. That the Secretary promulgated the 1984 Wage Index through a notice and comment procedure in the Federal Register must be considered to concede that the 1984 Wage Index is a legislative rule.

In correctly determining that the APA did not sanction the Secretary's retroactive 1984 Wage Index rule, the court below explained that equitable considerations are irrelevant to this determination:

> The instant case does not in any way involve a new agency policy articulated in the course of adjudication. Rather, it involves a *legislative rule* adopted by the Secretary pursuant to the notice and comment procedures of the APA, 5 U.S.C. § 553 (1982). As recognized in *Retail Union* itself, the APA requires that legislative rules be given future effect only. Because of this clear statutory command, equitable considerations are irrelevant to the determination of whether the Secretary's rule may be applied retroactively; such retroactive application is foreclosed by the express terms of the APA. 821 F.2d at 757 (emphasis in original).

Consequently, the court correctly held that retroactive application of the 1984 Wage Index is barred by the APA.

This ruling is consistent with the Attorney General's interpretation of the APA, *i.e.*, that retroactive rulemaking is generally prohibited (unless there is a finding of "good cause"). § 553(d). The Attorney General's Committee on Administrative Procedure states that the issuance of retroactive rules

should be "accompanied by the finding required by section 4(c) [requiring good cause]." Attorney General's Manual 37.

This result is consistent with the recent decision of the United States District Court for the Central District of California, in *West Anaheim, supra*. There, the court invalidated the retroactive application of a Medicare reimbursement rule and expressly followed the *Georgetown* ruling below. The court stated that "the APA envisions only prospective application of general legislative rule making." Use of a balancing test is appropriate only in determining the validity of retroactive application of policies adopted *in the course of agency adjudications*. *See Securities and Exchange Commission* v. *Chenery Corp.*, 332 U.S. 194, 91 L.Ed. 1995, 67 S.Ct. 1575 (1947); *J.L. Foti Construction Co.* v. *Occupational Safety & Health Commission*, 687 F.2d 853 (6th Cir. 1982).

The court in *Retail, Wholesale & Department Store Union* v. *NLRB*, 466 F.2d 380 (D.C. Cir. 1972), stated that rules adopted pursuant to formal rulemaking proceedings "are prospective in application only," 466 F.2d at 383, and the United States Supreme Court in *Chenery* referred to "quasi-legislative promulgation of rules to be applied in the future." 332 U.S. at 202. Under these authorities, the 1984 Wage Index rule cannot be applied retroactively.

Related to the principle that the 1984 Wage Index may not be applied retroactively is the consistent holding of the courts that, upon invalidation of a Medicare reimbursement rule, the prior rule in effect is reinstated. *See, e.g., Cumberland Medical Center* v. *Secretary of Health & Human Services*, 781 F.2d 536 (6th Cir. 1986); *Mason General Hospital* v. *Secretary of Department of Health and Human Services*, 809 F.2d 1220 (6th Cir. 1987); *Abington Memorial Hospital* v. *Heckler*, 750 F2d 242, 244 (3rd Cir. 1984) *cert. denied*, 88 L. Ed. 2d 149, 106 S.Ct. 180 (1985). In *Cumberland*, the Sixth Circuit invalidated a Medicare reimbursement rule, stating that "we cannot accept the Secretary's argument that the prior regulation cannot be reinstated." 781 F.2d at 539. The court explained:

> The five circuit courts that have considered this issue or stated the relief to be granted have ordered reimburse-

ment under the prior regulation. The common rationale is that the current rule being invalid from its inception, the prior regulation is reinstated until validly rescinded or replaced. 781 F.2d at 538 (footnote omitted).

Likewise, the *Georgetown* D.C. court below explained:

> This circuit has previously held that the effect of invalidating an agency rule is to '*reinstat[e]* the rules previously in force.' *Action on Smoking & Health* v. *CAB*, 713 F.2d 795, 797 (D.C. Cir. 1983) (emphasis added); *accord Menorah Medical Center* v. *Heckler*, 768 F.2d 292, 297 (8th Cir. 1985); *Abington Memorial Hosp.* v. *Heckler*, 750 F.2d 242, 244 (3d Cir. 1984), *cert. denied*, 106 S.Ct. 180 (1985). Accordingly, when the District Court vacated the Secretary's *1981* wage-index rule, it necessarily reinstated the Secretary's *1979* rule, which required the Secretary to reimburse providers using a formula that included federal-hospital data . . . 821 F.2d at 757-58 (emphasis in original).

Allowing the Secretary to retroactively apply the invalidated rule allows the Secretary a "second chance" at lawful promulgation. *Cumberland*, 781 F.2d at 539. The gravity of the Secretary's action here is even greater than in *Cumberland* because the Secretary's attempt at this "second chance" is the result of invalidation of the prior rule for noncompliance with APA rulemaking requirements. Numerous cases decided within the past 18 months show that the Secretary's attempts to retroactively apply Medicare reimbursement rules in the face of prior illegal conduct by the Secretary have failed. *Tallahassee Memorial Regional Medical Center* v. *Bowen*, 815 F.2d 1435 (11th Cir. 1987); *West Anaheim Community Hospital* v. *Bowen*, No. 84-4452-WDK (C.D. Cal. July 16, 1987); *Albany General Hospital* v. *Heckler*, No. 83-851-FR, Medicaid and Medicare Guide (CCH) 36,289 (D.C. Ore. January 22, 1987); *Miami General Hospital* v. *Bowen*, 652 F. Supp. 812 (S.D. Fla. 1986); and *Mason General Hospital* v. *Department of Health and Human Services*, 809 F.2d 1220 (6th Cir. 1986).

This Court can and should repeat once again the stern and unwavering message being sent to the Secretary by the federal judiciary—that his attempt to avoid the consequences of issuing arbitrary and capricious rules by promulgating similar (or, in this case, identical) replacement rules with retroactive effect will not be countenanced. If a rule is invalid, the prior valid rule must remain in effect until replaced by a valid rule with *prospective* effect.

III.

The Secretary Cannot Show That Retroactive Application of the Wage Index Serves Statutory Interests.

Even in those cases where, *unlike here*, the particular agency does have some retroactive rulemaking authority, case law shows that such powers may not be wielded absent *compelling* circumstances. The Secretary cannot show the existence of such circumstances here to warrant his wielding of such an unusual power. In *Mobil Oil Corp.* v. *Department of Energy*, 678 F.2d 1083 (Temp. Emer. Ct. App. 1982), the court set forth standards to determine the validity of a rule promulgated retroactively, where the original rule had been invalidated.

Recognizing that rules are rarely applied retroactively, and that the authority to do so "is even more limited when the rule promulgated has previously been invalidated by a court," the court stated that the test is *stringent:*

> Was the 1981 repromulgation of the 1974 amendment necessary to fulfill a statutory design, or would the failure to give retroactive effect to the 1981 amendment "do violence to the law as Congress wrote it?"

678 F.2d at 1090.

The court in *Mobil Oil* determined that the Department of Energy did not meet its burden to apply regulations retroactively. The court emphasized that the Department did not show "a compelling reason to allow a retroactive repair," *id.*, *i.e.*, the likelihood of significant harm unless the rule was applied retroactively:

> Since the DOE has not shown that there will be a significant "mischief of producing a result contrary to a statutory design . . . ," we conclude that the retroactive repromulgation of the 1974 amendment is invalid. *Id.*

This analysis was also applied in the trial court below, where the court held that retroactive application of the 1984 Wage Index did not serve statutory interests.

Mason General, supra, is an especially apt case because the Secretary, as in this case, attempted to take a second bite at the apple by issuing a similar rule (seven years later) after the first rule had been invalidated. In *Cumberland,* the Secretary's 1979 Medicare Malpractice Rule (dealing with the amount of reimbursement a provider would receive for malpractice insurance) was declared invalid. Subsequently, as in this case, the Secretary in 1986 purported to reissue the rule (though in slightly modified form) for public comment, and then did issue the rule in final form *on a retroactive basis,* to the date of the 1979 Rule.

The *Mason* court held that the Secretary had very little authority to issue retroactive rules and that he had *no* authority to issue a retroactive rule in the case before it[1] because the rule was not integral to a statutory purpose:

> None of the parties to this case challenge the fact that the determination of reimbursable costs under the Medicare Act involves "substantive" rulemaking by the agency, and as such, must be issued in conformity with the pro-

[1]The *Mason* court applied the following factors:

1. the degree of capriciousness or abuse of discretion exhibited by the agency in the promulgation of the initial rule;
2. the existence and duration of a prior settled regulation or practice, and the extent to which the initial invalidated rule constituted a substantial change in such settled practice; and,
3. the extent to which the change embodied in the initial invalidated rule was integral to the effectuation of the statutory purpose. (809 F.2d at 1228.)

cedures set forth in the APA. However, agencies are also empowered to issue "interpretive" rules pursuant to the quasi-judicial process of hearings conducted in individual cases. Generally, such quasi-judicial rulemaking is accorded deference by the courts in view of the necessity that an agency be capable of responding with flexibility to unforeseeable specialized problems as they arise. See *SEC* v. *Chenery Corp.*, 332 U.S. 194, 202-03, 67 S.Ct. 1575, 1580, 91 L.Ed. 1995 (1947) (upholding retroactive clarification of uncertain law through adjudication). The Supreme Court in *Chenery* also admonished, however, that since an agency has "the ability to make new law prospectively through the exercise of its rulemaking powers, . . . [t]he function of filling in the interstices of the Act should be performed, as much as possible, through this quasi-legislative promulgation of rules *to be applied in the future.*" Id. at 202, 67 S.Ct. at 1580 (emphasis added). As aptly noted by K.C. Davis in his Administrative Law Treatise:

> A basic distinction must be recognized between (1) new applications of law, clarifications, and additions, and (2) substitution of new law for old law that was reasonably clear. The first is natural, normal, and necessary. The second raises problems of fairness to those who have relied on the old law.

Id., 20:7 at 23 (1983). Therefore, we note that an agency attempting to promulgate a rule pursuant to APA procedures bears a heavy burden to justifying retroactivity in view of the Act's goal of assuring that new rules be of prospective application only.

* * * *

> Based on the foregoing, we cannot find that the change which the Secretary attempted to impose via the 1979 Rule was essential to the effectuation of the statutory purpose. 829 F.2d at 1224-25, 1230.

Likewise here, this case does not constitute the special circumstances required before such authority may be exercised. Importantly, the *Mason* court also stated that "In the proper

case, it may also be appropriate to consider both the existence or degree of any appearance of agency abuse of discretion in the procedural promulgation of a replacement rule and the extent to which the repromulgated rule differs substantively from the invalidated rule. . . ." 809 F.2d at 1231, n.9. These factors likewise militate in favor of invalidation of the 1984 Wage Index.

The changes embodied in the 1981 Wage Index and 1984 Wage Index were not necessary to effectuate statutory purposes or to fill a regulatory gap. The Secretary would have excluded such data from the *1979 Wage Index* if the exclusion were integral to statutory purposes. Furthermore, the Secretary did not implement this change when he made adjustments to the first wage index in 1980. 45 Fed. Reg. 41868 (June 20, 1980). Moreover, the change in the 1981 Wage Index was *contrary* to the statutory purpose because the wage index fails to take into account major competitors of providers.

Indeed, the view that "wages paid by a federal hospital do not reflect the local economy since federal wages are based primarily on national pay scales," 49 Fed. Reg. at 46497, a view held by the Secretary, is not the result of a study but is rather an unsupported "belief" (49 Fed. Reg. at 46497) and a "theory" (49 Fed. Reg. at 46498). An agency rule is invalid if it is based on a study which does not support the rule's premises. *Walter O. Boswell Memorial Hospital* v. *Heckler*, 749 F.2d 788, 803 (D.C. Cir. 1984); *Almay, Inc.* v. *Califano*, 569 F.2d 674, 682 (D.C. Cir. 1977); *Cumberland Medical Center, supra*, (Medicare reimbursement rule invalidated). Because both the 1981 and the 1984 Wage Index were the product of a mere "belief" on the part of the Secretary without any substantiation or verification, they are invalid. *Id.*

The Secretary has stated, contradictorily, that the exclusion of federal hospital data is a "minor technical chang[e]." 46 Fed. Reg. at 33,638, 639. In the final notice on November 26, 1984, the Secretary responded to a comment using the same rationale: "We consider the change that was made to the wage index a *minor technical change*." 49 Fed. Reg. at 46, 498 (emphasis added). Yet, immediately preceding this response,

the Secretary stated "[e]ven though only a limited number of hospitals are adversely affected by the exclusion of Federal hospital wage data, *a significant* amount of Medicare reimbursement is involved for each individual hospital that is affected," *Id.* at 46,497 (emphasis added), demonstrating contradictory reasoning. *See also Id.* at 46,497 ("we are not causing any undue hardship"); 49 Fed. Reg. at 6,177 (reissuance "would impose only a minimal burden on a few hospitals").

As noted by the district court in *DCHA:*

> Moreover, defendants are caught in contradiction when they leap from a description of the wage index change as "minor" to their argument that notice and comment would have been "contrary to the public interest." Defendants argue that the change in the formula was so insignificant that it produced only a "very limited . . . small impact." Points and Authorities, *supra*, at 21-22. Yet they also argue that the public interest justified acting without awaiting public participation because the new schedule would save the public money and protect against "windfalls" totaling "hundreds of thousands of dollars." This contradictory rationale is the stuff of which arbitrary and capricious decisions are made. [*DCHA*, *supra*, at p. 9368.]

Because the changes implemented by the 1984 Wage Index were not essential to the effectuation of a statutory purpose, the 1984 Wage Index fails to meet the standards of compelling circumstances to justify retroactivity.

IV.
The Secretary Again Violated APA's Notice and Comment Requirements.

The Secretary's 1984 rule is invalid for his failure to afford legitimate notice and comment before issuing the rule.

On February 17, 1984, the Secretary issued a proposed notice in the Federal Register requesting public comment on the 1984 Wage Index. 49 Fed. Reg. 6175. The Secretary received public comment and purported to reply to the comment, but—as

demonstrated below—he had already made up his mind to issue the rule, and no amount of "public comment" could change his mind. The Secretary next published the 1984 Wage Index as originally calculated, with retroactive effect to 1981. 49 Fed. Reg. 46,495. The Secretary's after-the-fact, pro forma provision for public notice and comment does not comply with the APA. If permitted, the Secretary's charade would eviscerate the mandate of effective, pre-decisional, public participation in rulemaking and would render the APA's notice and comment requirements a nullity.

Case law makes it clear that post-promulgation notice and comment is invalid. For example, in *United States Steel Corp.* v. *United States Environmental Protection Agency*, 595 F.2d 207, *reh'g granted*, 598 F.2d 915 (5th Cir. 1979), the court rejected the United States Environmental Protection Agency argument that the agency's acceptance of post-promulgation comments with an "open mind" satisfied the APA:

> Section 553 is designed to ensure that affected parties have an opportunity to participate in and influence agency decision making at an early stage, when the agency is more likely to give real consideration to alternative ideas. Other courts have recognized this difference and rejected arguments similar to that asserted here:
>
> > Permitting the submission of views after the effective date is no substitute for the right of interested persons to make their views known to the agency in time to influence the rule making process in a meaningful way . . . "We doubt that persons would bother to submit their views or that the Secretary would seriously consider their suggestions after the regulations are a *fait accompli*."
>
> *Id.* at 214-15 (quoting extensive authority), *quoted in New Jersey* v. *United States Environmental Protection Agency*, 626 F.2d. 1038, 1049-50 (D.C. Cir. 1980); *accord, Sharon Steel Corp.* v. *Environmental Protection Agency*, 597 F.2d 377, 381 (3rd Cir. 1979). The *United States Steel* court also recognized that:

> Were we to allow the EPA to prevail on this point [that the EPA might cure a failure to give prior notice and comment on a rule by providing for notice and comment after promulgation] we would make the provisions of § 553 virtually unenforceable. An agency that wished to dispense with pre-promulgation notice and comment could simply do so, invite post-promulgation comment, and republish the regulation before a reviewing court could act.

595 F.2d at 215.

As in *United States Steel*, the Secretary cannot comply with the APA by providing for after-the-fact public notice and comment as was done here. Soliciting comments after the agency had already made up its mind does not comply with the APA, and is a mockery of the rulemaking process.

In *South Carolina ex rel. Patrick* v. *Block*, 558 F. Supp. 1004, 1006 (D.S.C. 1983), the Secretary of Agriculture determined to require "a deduction of 50 cents per hundredweight from proceeds of sales of all milk marketed commercially in the United States." The Secretary of Agriculture provided for notice and public comment only on the implementation of the determination. The court rejected the Secretary of Agriculture's contention that he had substantially complied with the APA by soliciting after-the-fact comments on the implementation plan.

In holding the Secretary's actions invalid, the court stated: "The Final Rule shows that the deduction was an accomplished fact from the outset. There is nothing to indicate that anything that was said or that could have been said by way of comment would have swayed the Secretary in his determination to impose the deduction." *Id.* at 1010. The court also held:

> The record is clear. I find that the Secretary set his mind very early on that he would impose the deduction. *There were no procedures by which interested persons would have an input into this decision comparable to that which is required by 5 U.S.C. § 553.* Accordingly, I find that the public was given no opportunity for meaningful

comment on whether the Secretary would impose the fifty cents per hundredweight deduction before he made his decision.

Even assuming that the Secretary was of an open mind after he issued the Notice of Determination of September 24, *the cases make clear that the allowance of post hoc comment is no substitute for the right to comment on a proposed rule before the administrator makes his decision*. The purpose of the notice and comment requirement of 5 U.S.C. § 553 is to allow interested parties to voice their views before a rule comes into effect, when there is greater likelihood that the administrator or agency will be receptive to information and argument. *In the long run, to permit agencies to resort to post facto comment would allow them to negate at will the Congressional decision that notice and the opportunity to comment must precede decision, and would deprive parties of all effective means to enforce the rights granted by this section.*

Id. at 1020-21 (emphasis added).

As in *South Carolina ex rel. Patrick*, the Secretary never provided the public with the opportunity to influence the decision to exclude federal hospital data. The Secretary had already decided, prior to soliciting public comment, to apply the same methodology the *DCHA* court had invalidated. *Indeed, over a month before the Secretary issued the notice to reissue the 1981 Wage Index for public comment, the Secretary issued a final rule to implement PPS, 49 Fed. Reg. 234 (1984) which rejected several public comments "object[ing] to the continued exclusion of (BLS) wage and employment records from Federal hospitals to derive the wage index."* *Id.* at 257. The Secretary stated there that: "continuing to exclude Federal hospital statistics from the BLS data used to construct the wage index *is appropriate*." *Id.* at 258 (emphasis added).

Thus, the Secretary purported to request comments on a wage index methodology *that the Secretary had already determined to apply*. No amount of public comments could have changed the Secretary's mind about using federal hospital data in a similar wage index. The notice and comment

procedure was a charade, and constituted a clear violation of effective, pre-decisional notice and comment participation.

In fact, the very language that the Secretary used in issuing the rule for "comment" demonstrates that the Secretary was not seriously considering the appropriateness of the decision. The Secretary was merely attempting to satisfy a court's scrutiny. The February 17, 1984 proposed notice stated "*We are reissuing for public comment* the change in the types of data that were used to calculate the [1981] wage index." 49 Fed. Reg. at 6175 (emphasis added). The November 26, 1984 final notice stated even more clearly the Secretary's limited purpose in the proposed notice. "The February 17, 1984, proposed notice *was intended to remedy the rulemaking deficiencies perceived by the District Court and to validate* use of the 1981 schedule of hospital cost limits by bringing the wage index contained in the 1981 schedule of limits into compliance with the APA." 49 Fed. Reg. at 46,496 (emphasis added).

Later, the Secretary used more tell-tale language: "By issuing a proposed notice and final notice, *we are correcting a procedural defect* of not soliciting public comments *before making a change in methodology*." *Id.* at 46,497 (emphasis added). The Secretary further stated: "By republishing the same wage index at this time, *we are correcting the procedural defect perceived by the court;* that is, the failure to provide a *comment period*." *Id.* at 46,498 (emphasis added).

As amply demonstrated, and as determined by the court below, the Secretary decided *in 1981* to calculate the 1981 Wage Index without using federal hospital data. The Secretary's reissuance of the same 1981 Wage Index in 1984 for public comment was solely an attempt to satisfy a court's scrutiny and not to reconsider that decision. As such, this post-hoc, pro forma process does not satisfy the APA's requirement for meaningful, pre-decisional public participation in the administrative process, and must be rejected.

CONCLUSION

For the foregoing reasons, the decision of the D.C. Court of Appeals should be affirmed.

Respectfully submitted,

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No. 87-1097

In the Supreme Court of the United States

October Term, 1987

OTIS R. BOWEN, M.D., Secretary of Health and Human Services,

Petitioner,

v.

GEORGETOWN UNIVERSITY HOSPITAL, *et al.*,

Respondents.

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE DISTRICT OF COLUMBIA CIRCUIT

BRIEF AMICUS CURIAE OF THE AMERICAN HOSPITAL ASSOCIATION IN SUPPORT OF THE RESPONDENTS

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Petition for Writ of Certiorari Granted February 29, 1988

QUESTION PRESENTED

Whether the Administrative Procedure Act or the Medicare statute permit the Secretary of Health and Human Services to promulgate a legislative rule with retroactive effect.

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INTEREST OF THE AMERICAN HOSPITAL ASSOCIATION

Amicus curiae American Hospital Association ("AHA") respectfully submits this brief in support of the Respondents. AHA has obtained the written consent of both Petitioner and Respondents to the filing of this brief *amicus curiae*.

AHA, a not-for-profit membership corporation organized under the laws of the State of Illinois, is the primary organization of hospitals in the United States. Its membership includes approximately 6,000 hospitals and other health care institutions, as well as approximately 45,000 individuals. The principal corporate objective of AHA is to promote high qual-

ity health care and health services for all people by providing leadership and assistance to hospitals and health care organizations in meeting the health care needs of their communities.

The overwhelming majority of AHA's institutional members participate as providers of services in the program of health insurance for the aged and disabled established by Title XVIII of the Social Security Act, 42 U.S.C. §§ 1395-1395ccc (West Supp. 1983 & 1988), known as the Medicare program, and thus are subject to the rules issued to implement the Medicare program. These rules are numerous, and address eligibility of beneficiaries, coverage of services, and payment levels.

Payments made to hospitals on behalf of beneficiaries of the Medicare health insurance program account for approximately 40% of the revenue of most AHA member hospitals. Reimbursement for services furnished to Medicare beneficiaries is, necessarily, a major factor considered by such hospitals in their financial planning, and can affect the continued ability of hospitals to provide needed services to Medicare beneficiaries and others in the community.

Accordingly, AHA and its members have a strong interest in the integrity and reliability of the rulemaking process. In particular, AHA and its members have an immediate and continuing concern regarding sound government policies and procedures affecting the administration of the program, including procedures used to implement changes in the reimbursement rules applicable to Medicare providers.

At issue in this case is an attempt by the Secretary of Health and Human Services ("Secretary") to bypass the requirements of the Administrative Procedure Act, 5 U.S.C. §§ 551-706 (West 1977) ("APA"), in his administration of the Medicare program.[1] AHA suggests that the Court reject

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[1] With the advent of the Medicare prospective payment system established by Title VI of the Social Security Amendments of 1983, Pub. L. No. 98-21, §§ 601-607, 97 Stat. 149-172, and applicable to inpatient services of most hospitals, the practical significance of the specific regulation at issue here is somewhat

(Footnote continued on the following page)

the Secretary's argument that his power under the Medicare statute extends to the promulgation of legislative rules with retroactive effect, and adopt the reasoning of the court of appeals, which is in harmony with both the plain language of the APA and the critically important policy considerations underlying it.

SUMMARY OF THE ARGUMENT

Amicus curiae American Hospital Association respectfully submits that the judgment of the United States Court of Appeals for the District of Columbia Circuit rejecting the Secretary's interpretation of the APA and the Medicare statute should be affirmed for the following reasons: First, the plain language of the APA requires that legislative rules promulgated by an agency be given prospective effect only. That language is controlling, absent an explicit grant of authority to the contrary in the agency's enabling statutes. The power sought here by the Secretary, to legislate rules with retroactive effect, is inconsistent with the philosophy and purpose of the APA scheme, which confers the force of law upon those rules which were promulgated pursuant to the rulemaking requirements of the APA. Permitting an agency to avoid those requirements as merely "procedural" would undermine the carefully drawn statutory scheme applicable to most federal administrative agencies and would seriously threaten the integrity of the rulemaking process. Second, the language of the Medicare statute provides no authority, explicit or otherwise, for legislative rulemaking with retroactive effect.

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1 *(Continued)*
diminished. The issue of whether the Secretary complies with the APA in his rulemaking functions remains of extreme importance to AHA member hospitals.

ARGUMENT

I. THE ADMINISTRATIVE PROCEDURE ACT PROHIBITS LEGISLATIVE RULES WITH RETROACTIVE EFFECT.

A clear understanding of the structure and purpose of the APA is critical to the resolution of the issue before the Court. That structure sought to clarify and codify the long-recognized distinctions between the legislative and judicial functions of administrative agencies, and was described in the House Report accompanying the legislation as follows:

> In stating the essentials of the different forms of administrative proceedings, the bill carefully distinguishes between the so-called legislative functions of administrative agencies (where they issue general regulations) and their judicial functions (in which they determine rights or liabilities in particular cases). It provides quite different procedures for the "legislative" and "judicial" functions of administrative agencies. In the "rule making" (that is, "legislative") function it provides that with certain exceptions agencies *must* publish notice and at least permit interested parties to submit their views in writing for agency consideration *before* the issuance of general regulations (sec. 4).

H.R. Rep. No. 1980, 79th Cong., 2d Sess. 251 (1946), [hereinafter *House Report*], *reprinted in* Senate, Administrative Procedure Act Legislative History, Sen. Doc. No. 79-248, 79th Cong., 2d Sess. at 251 (1946) [hereinafter *Legislative History*]. (Emphasis supplied.) By enacting this bill, the Congress intended to lay down "a policy respecting the minimum requirements of fair administrative procedure." S. Rep. No. 752, 79th Cong., 1st Sess. (1946) [hereinafter *Senate Report*], *reprinted in Legislative History, supra*, at 217.

The Secretary asserts that nothing in the APA deprives him of the power to issue, with retroactive effect, legislative

rules pursuant to section 4 of the APA, 5 U.S.C. 553.[2] Brief for the Petitioner at 21-25. That construction of the statute and the Secretary's arguments in support of it blur the fundamental distinction between the legislative rulemaking and adjudication procedures established by the APA. [3]

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[2] The Secretary states that his predecessor decided to adhere to the APA notice and comment rulemaking requirements in promulgating Medicare reimbursement regulations, waiving the benefit exception of section 553(a)(2) "[a]s a matter of internal policy." Brief for Petitioner at 6 n.3. The Secretary expressly and publicly waived the exception in 1971, however. 36 Fed. Reg. 2532 (1971); *Mason General Hospital v. Secretary of Health and Human Services*, 809 F.2d 1220, 1224 n. 3 (6th Cir. 1987). That action was prompted by a recommendation of the Administrative Conference of the United States. *Humana of South Carolina, Inc. v. California*, 590 F.2d 1070, 1084 & n.3 (D.C. Cir. 1978) (citing Recommendation No. 16 – Elimination of Certain Exemptions from the APA Rulemaking Requirements, 118 U. Pa. L. Rev. 611 (1970)).

[3] The Secretary's discussion of the case law and commentary concerning the issue of "retroactive rulemaking" confuses legislative rulemaking under the APA with adjudication; it also relies on cases decided before the enactment of the APA, cases involving retroactive statutes, and cases involving interpretative rules. *See* Brief for the Petitioner at 21-24. All but a few of these cases can immediately be distinguished. Some involve retroactive statutes; *see, e.g., Usery v. Turner Elkhorn Mining Co.*, 428 U.S. 1 (1976); some involve adjudication; *see, e.g., Heckler v. Community Health Services of Crawford Co.*, 467 U.S. 51 (1984); *Burlington Northern, Inc. v. United States*, 459 U.S. 131, 142 (1982); *NLRB v. Food Store Employees Union, Local 347*, 417 U.S. 1 (1974); *Texaco, Inc. v. Department of Energy*, 795 F.2d1021 (Temp. Emer. Ct. Ap. 1986); *Maxcell Telecom Plus, Inc. v. FCC*, 815 F.2d 1551 (DC. Cir. 1987); *Porter v. Senderowitz*, 158 F.2d 435 (3d Cir. 1946), *cert. denied*, 330 U.S. 848 (1947); some involve licensing or tariffs; *see, e.g., FPC v. Idaho Power Co.*, 344 U.S. 17 (1952); some involve interpretative rules; *see, e.g., Illinois v. Bowen*, 786 F.2d 288, 292-293 (7th Cir. 1986); *Daughters of Miriam Center for the Aged v. Mathews, 590 F.2d 1250*

(Footnote continued on the following page)

A. The Plain Language of the APA Precludes Legislative Rulemaking With Retroactive Effect.

In reviewing statutory interpretations by agencies, the courts first determine whether Congress has spoken directly to the precise question at issue; if the intent of Congress is clear, that is the end of the inquiry, for the courts must give effect to the unambiguously expressed intent of Congress. *NLRB v. United Food and Com'l Wkrs. Union, Local 23*, ___ U.S. ___, 108 S.Ct. 413, 421 (1988) (citing *Chevron, U.S.A., Inc. v. Natural Resources Defense Council, Inc.*, 467 U.S. 837, 842-843, & n.9 (1984)). Only if a statute is ambiguous or silent on the issue must a court consider the agency's interpretation. *Id.*[4] That the construction of the APA is left to the courts in the final analysis is made clear in the Senate Report:

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3 *(Continued)*
(3d Cir. 1978); *National Helium Corp. v. FEA*, 569 F.2d 1137 (Temp. Emer. Ct. App. 1977); and some are decisions predating enactment of the APA; *see, e.g., Addison v. Holly Hill Fruit Products, Inc.* 322 U.S. 607 (1944); *Twin City Milk Producers Ass'n v. McNutt*, 123 F.2d 396 (8th Cir. 1941); *Swayne & Hoyt, Ltd. v. United States*, 300 U.S. 297 (1937); *Miller v. United States*, 294 U.S. 435 (1935); *Arizona Grocery Co. v. Atchison, T. & S.F. Ry.*, 284 U.S. 370 (1932); *Graham & Foster v. Goodcell*, 282 U.S. 409 (1931); *Forbes Pioneer Boat Line v. Board of Comm'rs*, 258 U.S. 338 (1922); *United States v. Heinszen & Co.*, 206 U.S. 370 (1907). Other cases require only a careful reading to demonstrate that they are inapposite; *see, e.g., National Ass'n of Indep. Television Producers and Distributors v. FCC*, 502 F.2d 249 (2d Cir. 1974) (not true retroactive rulemaking); *General Telephone Co. v. United States*, 449 F.2d 846 (5th Cir. 1971) (rule requiring the discontinuance of certain activity within four years); *Citizens to Save Spencer County v. EPA.*, 600 F.2d 844 (D.C. Cir. 1979) ("ostensibly retroactive effect" only).

[4] If the Court were to consider the agency's interpretation of the statute, the Court also must consider, *inter alia*, whether the agency's technical expertise gives the agency an enhanced under-

(Footnote continued on the following page)

> *Interpretation and Enforcement.* – Except in a few respects, this is not a measure conferring administrative powers but is one laying down definitions and stating limitations. These definitions and limitations must, to be sure, be interpreted and applied by agencies affected by them in the first instance. But the enforcement of the bill, by the indepen dent judicial interpretation and application of its terms, is a function which is clearly conferred upon the courts in the final analysis.
>
> It will thus be the duty of reviewing courts to prevent avoidance of the requirements of the bill by any manner or form of indirection, and to determine the meaning of the words and phrases used. . . .

Senate Report, reprinted in Legislative History, supra, at 217.

The plain language of the statute, as well as the statutory scheme, mandate the conclusion that only adjudicative action may have retroactive effect under the APA. The statutory definitions laid down by Congress in section 2 of the APA, 5 U.S.C. 551, clearly separate the function of, and procedure for, legislative rulemaking and adjudication.

> "Rules" are often called "regulations" or "general regulations." The definition is important because it *determines* whether section 4 rather than section 5 applies to a regulatory operation. The specification of some of the activities that are rule making is included to illustrate and to embrace them in the definition beyond question. "*Rules*" *formally prescribe a course of conduct for the future rather than*

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4 *(Continued)*
standing of the issues. *Chevron*, 467 U.S. at 864-66. The construction of the APA put forth here by the Secretary is not the result of special expertise in interpreting the APA, and therefore is not entitled to deference in any event. *Bowen v. American Hospital Association*, 476 U.S. 610, 642 n.30 (1986) (deference based on expertise not justified when many agencies promulgate rules under same statute).

pronounce past or existing rights or liabilities.

House Report, reprinted in Legislative History, supra, at 254. (Emphasis supplied.) This formulation of the distinction was repeated by Representative Walter, author of the *House Report,* during consideration of the bill:

> In rule making an agency is not telling someone what his rights or liabilities are for past conduct or present status under existing law. Instead, in rule making the agency is prescribing what the future law shall be so far as it is authorized so to act.

Administrative Procedure Act: Proceedings in the House and Senate From Congressional Record of March 12 and 27, and May 24 and 25, 1946 (1946) [hereinafter *Congressional Record Proceedings], reprinted in Legislative History, supra,* at 355.

As the Attorney General recognized in what the Secretary has characterized as the "authoritative manual on the APA," Brief for the Petitioner at 33, this dichotomy between the two types of administrative functions is the very basis of the APA legislation. *See* U.S. Department of Justice, Attorney General's Manual on the Administrative Procedure Act 14 (1947) [hereinafter *Attorney General's Manual*]. Rulemaking is described in the *Attorney General's Manual* as an action "which regulates the future conduct," and one clearly distinct from adjudication, which concerns "the determination of past and present rights and liabilities." *Id.*

In its first decision addressing the issue, the Court explained the preference for prospective rulemaking under the APA statutory scheme:

> [Because an agency], unlike a court, does have the ability to make new law prospectively through the exercise of its rule-making powers, it has less reason to rely upon *ad hoc* adjudication to formulate new standards of conduct within the framework of [its enabling statute]. The function of filling in the interstices of the Act should be performed, as much as possible, through this quasi-legislative promulgation of rules to be applied in the future.

Chenery, 332 U.S. at 202.[5]

The *Chenery* Court also emphasized the avenues open to agencies in determining how to proceed to address an issue:

> In performing its important functions in these respects, therefore, an administrative agency must be equipped to act either by general rules or individual order.

Id. Once that decision is made, however, the nature of the effect is predetermined. If an agency engages in rulemaking, the effect is prospective only. If an agency decides to adjudicate, action with retrospective effect is possible, although only when the balancing tests are satisfied.

The Secretary disagrees. He asserts that the "future effect" language of the definition of rule is used "simply to distinguish rulemaking from adjudication." Brief for the Petitioner at 24. But that is precisely the point: the plain language of the statute reflects the congressional intent that agency action in the form of legislative rules be effective only prospectively. The process of rulemaking is "prescribing what the future law shall be; 'rulemaking' is not telling someone what his rights or liabilities are for past conduct or present law." *Congressional Record Proceedings, reprinted in Legislative History, supra,* at 355.

Finding no authority in the plain language of the statute to support his position, the Secretary relies upon what he characterizes as "explicit statements of legislative intent," Brief for the Petitioner at 33, but which upon close examination prove to be unrelated and unconvincing bits and pieces of legislative history. *See* Brief for the Petitioner at 25-33. One of the key "explicit statements of legislative intent" upon

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[5] More recently, the Court of Appeals for the Sixth Circuit reaffirmed that the goal of the APA is assuring that new rules be of prospective application only. *Mason General Hospital,* 809 F.2d at 1225.

which the Secretary relies is, in reality, simply the *absence* in the enacted legislation of any reference to "retroactive" rules, which reference had been made in some of the numerous bills and commentaries developed during the eight years of consideration and debate which preceded the passage of the APA. The Secretary states that "Congress's deliberate omission of the reference to retroactive rules is strong, if not dispositive, evidence that it did not intend to bar retroactive rule making in the APA." Brief for the Petitioner at 27.[6]

Contrary to the conclusion drawn by the Secretary, Congress did act to preclude some retroactive rulemaking–that of the legislative type. Some of the early bills to which the Secretary refers included explicit references to banning both retroactive rules *and* retroactive orders, a position that Congress obviously did not adopt. *Hearings Before the Committee on the Judiciary, House of Representatives on the subject of Federal Administrative Procedure*, 79th Cong., 1st Sess. (1945), *reprinted in Legislative History, supra*, at 55. Congress banned retroactive legislative rules, by definition, but permitted orders with retrospective effect.

The Secretary relies on *Bowen v. Galbreath*, ___U.S.___, 108 S.Ct. 892 (1988), to support the proposition that Congressional intent to allow retroactive legislative rulemaking may be inferred from the absence from the enacted APA of a separate section prohibiting such rulemaking. Brief for the Petitioner at 25. In *Galbreath*, this Court concluded that Congress had intentionally omitted from a statute a provision

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[6] If one were to adopt the Secretary's approach to statutory construction, one would be forced to conclude that Congress's "deliberate omission" from legislation of a proposed Medicare provision which would have given the Secretary the power to make retroactive rules, is "strong, if not dispositive, evidence" that Congress did not intend the Secretary to have such power. *See Tallahassee Memorial Regional Medical Center v. Bowen*, 815 F.2d 1435, 1453 n. 36 (11 Cir. 1987), *cert. denied*, ___U.S.___108 S.Ct. 1573 (1988) (discussing S. 1550, 99th Cong., 1st Sess. 115 (1985)).

which proposed payment of attorney's fees out of benefits provided under the statute. This intent was evidenced by explicit statements from both of the Congressional reports accompanying the legislation, however. *See* ___U.S. at ___, 108 S.Ct. at 894. In fact, the House Report stated that the intent of that statute would be defeated if attorney's fees were paid from withheld benefits. *Id.*

In the present case, despite the fact that he has evidently canvassed the materials thoroughly, the Secretary has not identified any language in the statute or the legislative history which either authorizes retroactive legislative rulemaking or reflects a Congressional decision that no position would be taken.[7]

The Secretary quotes Professor Davis for the general proposition that "[l]ike retroactive statutes, retroactive rules are valid if they are reasonable but are invalid if their retroactivity is unreasonable in the circumstances." 2 K. Davis, *Administrative Law Treatise* § 7:23, at 109 (2d ed. 1979). *See* Brief for the Petitioner at 22. Professor Davis addresses the issue more precisely than the Secretary's quotation suggests, however; he acknowledges the confusion to be found in the case law, and states the "ideal" interpretation of agency power:

> Although the argument is plausible that legislative rules may be retroactive whenever a statute may be, since the fairness or unfairness is the same and judicial ideas of fairness are decisive, rules differ [from statutes] in two main respects - agencies have no powers except those conferred and courts are reluctant to imply power to issue retroactive rules, and courts give greater deference to judgments of legislative bodies than to judgments of agencies. The ideal

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[7] The informal five-sentence exchange during the House hearings between Representative Wynne and Chairman McFarland, quoted by the Secretary, Brief for Petitioner at 28-29, does not constitute an "explicit statement of legislative intent".

> might be to tolerate retroactive rules only when they are specifically authorized by a statute, but courts' holdings fall well short of that ideal.

2 K. Davis, *Administrative Law Treatise* § 7:23, at 109 (2d ed. 1979). That "ideal" is consistent with both the language of the APA and the philosophy underlying it.

Nor does the language quoted by the Secretary from the *Attorney General's Manual*, *supra*, and the *House Report*, *supra*, support the Secretary's reading of the statute. *See* Brief for the Petitioner at 33-34. Although the *Attorney General's Manual* speaks of "retroactive" rules in the legislative rule context, it is clear from the context of the sentence quoted by the Secretary that the quoted statement refers to as "retroactive" rules effective immediately upon publication, without the 30-day notice period of 5 U.S.C. § 553(c) (West 1977).

> Also, it is clear from the legislative history that for good cause an agency may put a substantive rule into effect immediately; in such event, the requirement of prior publication is altogether absent, and the rule will be come effective upon issuance as to persons with actual notice, and as to others upon filing with the Division of the Federal Register [citations deleted]. Nothing in the Act precludes the issuance of retroactive rules when otherwise legal and accompanied by the finding required by section 4(c).

Attorney General's Manual, *supra*, at 37. Section 4(c), 5 U.S.C. § 553(c), provides the effective date for regulations. Read in context, the cited passages stand only for the proposition that a rule *can* be effective as early as the date it is filed with the Federal Register or the date on which affected parties receive notice, but not before, and not without the justification required by section 4(c).

The Secretary also complains that the respondents misapprehend the scope of an agency's authority on remand, citing *Chenery*, and suggesting that the Secretary is free to engage in legislative rulemaking with retroactive effect to "cure" the

"cure" the procedural defects identified by the district court. Brief for the Petitioner at 15-16. The Court's decision in *Chenery*, however, stands only for the proposition that an agency may use adjudication in carrying out the agency's function of interpretation and applying its rules and regulations.

At issue here is legislative rulemaking, as opposed to adjudicative action. Adjudicative action with retroactive effect is common in the process of interpreting a statute or legislative rules pursuant to hearings and consideration of individual cases; it allows an agency to respond with flexibility to unforeseeable specialized problems as they arise and is necessarily applied retroactively. *Chenery*, 332 U.S. at 202-03.

Recognizing that adjudication frequently involves retroactive effects which, even if permissible on balance, result in harm to those affected, the courts have frequently encouraged agencies to use rulemaking rather than adjudication whenever possible to announce agency policies of general applicability. *See, e.g., NLRB v. Majestic Weaving Co., Inc.*, 355 F.2d 854, 860 (2d Cir. 1966). It is true, as the Court pointed out in *Chenery*, that on remand the agency retains authority to proceed to deal with the issue afresh. 332 U.S. at 200-201. It is also true, however, that on remand the agency confronts the same decision it had originally: to proceed by rulemaking or adjudication.[8] *Chenery* dealt only with adjudication.

The principle that invalidation of a regulation reinstates the prior valid regulation follows necessarily from the nature

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[8] The *Chenery* analysis recognizes that each type of action is a valid administrative tool and that each has a different purpose. Rulemaking is the proper tool for announcing policies of general applicability, while adjudication is the proper tool for adjusting an agency's interpretation of a rule to particular circumstances. 332 U.S. at 200-01.

of legislative rules as rules of prospective effect. The prior valid regulation simply continues in force until replaced by another *valid* regulation or until overruled by statutory amendment. *See, e.g., Cumberland Medical Center v. Secretary of Health and Human Services*, 781 F.2d 536 (6th Cir. 1986); *Action on Smoking and Health v. CAB*, 713 F.2d 795, 797 (D.C. Cir. 1983)

B. Legislative Rules with Retroactive Effect Would Undermine the Procedural Safeguards of the APA.

Generally, "courts are charged with . . . ensuring that agencies comply with the 'outline of minimum essential rights and procedures' set out in the APA." *Chrysler Corp. v. Brown*, 441 U.S. 281, 313 (1979). With respect to substantive policy changes, those minimum procedures include: publishing notice of a proposed rule to advise interested parties of the nature and scope of regulatory action under consideration; allowing interested parties an opportunity to participate in the rulemaking process through submission of written data, views, or arguments; considering relevant comments and materials furnished by the public; and publishing the rules incorporating a concise general statement of the rule's purpose. 5 U.S.C. § 553 (West 1977). Congress established these procedural requirements to benefit both the agency and the regulated entities. *See, e.g., Abington Memorial Hospital v. Heckler*, 576 F. Supp. 1081, 1084-87 (E.D. Pa. 1983), *aff'd*, 750 F.2d 242 (3d Cir. 1984).

The Secretary argues here that, despite his failure to adhere to these requirements in publishing a rule, he can later simply reissue the same rule, retroactive to the date of the invalid rule, to "correct" procedural defects. The Secretary's position "trivializes the procedures mandated by the Administrative Procedure Act." *Mason General Hospital*, 809 F.2d at 1231, and its adoption would threaten the procedural safeguards carefully put in place by Congress.

In the instant case, the court of appeals properly rejected

the Secretary's suggestion that retroactive rulemaking is permissible in order to remedy a procedural defect in a rule, and observed that if the Secretary's position were adopted, agencies would be free to violate the rulemaking requirements with impunity. *Georgetown University Hospital v. Bowen*, 821 F.2d 750, 758 (D.C. Cir. 1987).

Although the Secretary should be permitted to correct procedural defects in regulations, the avenues available for this form of administrative action are legislative rulemaking, which has prospective effect, or adjudication, which can have retroactive effect if justified under the traditional balancing test. *See Retail, Wholesale & Dep't. Store Union v. NLRB*, 466 F.2d 380 (D.C. Cir. 1972).

AHA files this brief primarily in response to what it perceives to be a developing pattern on the part of the agency of ignoring APA requirements in the Medicare context. Most notably, the Secretary has attempted, in two recent major cases affecting hospitals throughout the nation, to subvert APA procedures through the use of retroactive rulemaking.

The first instance involves one of the most extensively litigated APA cases in history; in 1979, the Secretary promulgated a legislative rule regarding Medicare reimbursement of malpractice insurance costs. This rule, which drastically changed the method of reimbursement for that category of costs, was promulgated without compliance with notice and comment procedures required under 5 U.S.C. § 553(b)-(d) (West 1977), and was subsequently invalidated in almost

every federal circuit.[9]

After several years of litigation and numerous convincing defeats, the Secretary refused to apply the prior valid rule governing malpractice insurance costs, as would ordinarily be the case when a rule is invalidated.[10] Instead, the Secretary promulgated yet another rule in 1986 and attempted to apply that rule retroactively to 1979.[11]

The second instance, and the subject of this litigation, was the Secretary's attempt in 1984 to repromulgate, with effect retroactive to 1981, a Medicare wage index which he had illegally promulgated in 1981.

In both of these instances, the Secretary is attempting to put himself in a better position than he would have been

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[9] This issue was litigated in more than 90 federal district court cases and has been addressed by almost all of the federal courts of appeals in the nation. *See Cumberland Medical Center*, 781 F.2d 536; *Bedford County Memorial Hospital v. Health & Human Services*, 769 F.2d 1017 (4th Cir. 1985); *Menorah Medical Center v. Heckler*, 768 F.2d 292 (8th Cir. 1985); *DeSoto General Hospital v. Heckler*, 766 F.2d 182 (5th Cir. 1985); *Lloyd Noland Hospital and Clinic v. Heckler*, 762 F.2d 1561 (11th Cir. 1985); *St. James Hospital v. Heckler*, 760 F.2d 1460 (7th Cir. 1985), *cert. denied*, 474 U.S. 902 (1985); *Humana of Aurora, Inc. v. Heckler*, 753 F.2d 1579 (10th Cir. 1985), *cert. denied*, 474 U.S. 863 (1985); *Abington Memorial Hospital v. Heckler*, 750 F.2d 242 (3d Cir. 1984), *cert. denied*, 474 U.S. 863 (1985).

[10] *See, e.g., United States v. Baltimore & Ohio Railroad Company*, 284 U.S. 195, 203-04 (1931); *Mason General Hospital*, 809 F.2d at 1223, 1229; *Tallahassee Memorial Regional Medical Center*, 815 F.2d at 1453 n.35, 1455-1456; *Abington Memorial Hospital v. Heckler*, 750 F.2d at 244; *Lloyd Noland Hospital & Clinic v. Heckler*, 762 F.2d at 1569; *Menorah Medical Center*, 768 F.2d 297.

[11] *See Mason General Hospital*, 809 F.2d 1220; *Tallahassee Memorial Regional Medical Center*, 815 F.2d 1435; *Walter O. Boswell Memorial Hospital v. Heckler*, 749 F.2d 788 (D.C. Cir. 1984).

in had he *followed* the APA procedures and legally promulgated the rules. As the court stated in *Tallahassee Regional Memorial Center v. Bowen*:

> Such an approach must be rejected; it would permit the Secretary to benefit from the 1979 rulemaking, even though the hospital successfully attacked the 1979 rule.

815 F.2d at 1455. That court provided a fitting analogy for what the Secretary has characterized as "curative" retroactive rulemaking:

> In football, if a team gains ten yards on a play in which it commits a five yard penalty, the ball is typically taken back to the original line of scrimmage and the five yard penalty is counted off from there. Adopting the Secretary's approach would be like taking five yards off from the point where the play ended (and thus allowing the team a net five yard gain on a play in which it committed an infraction).

815 F.2d at 1455 n.41.

Hospitals are complex organizations. In order to be run effectively, they must be given fair notice of new rules and procedures so that they may adjust their operations. If the Secretary is permitted to apply new rules retroactively, and effectively give hospitals one-day notice of significant changes in reimbursement, for example, the fiscal planning hospitals have undertaken in reliance on prior rules will be thwarted. This type of retroactive rulemaking "interferes with the legally-induced and settled expectations of [the hospitals]." *Daughters of Miriam Center*, 590 F.2d at 1260.

By contrast, if the Secretary were consistently required to follow APA rulemaking procedures from the beginning, and not permitted to "correct" invalid rules retroactively, hospitals and other regulated persons and institutions would have a clear set of rules and policies to follow, and not be forced to make budget and internal policy decisions based upon speculation and guesswork.

In addition to the adverse practical consequences of the

Secretary's failure to comply with the APA, it is possible to envision further negative effects. As the malpractice cases demonstrate, retroactive rulemaking can be used to prevent judicial review of agency regulations, and can be used to moot a case after years of litigation. The court in *Tallahassee* noted two potential abuses in this respect:

> First, [allowing retroactive rulemaking] would be creating a situation in which an agency, if it were inclined, could avoid review of an agency action and potentially abuse the review process. The ability to moot a case by replacing a challenged regulation with a similar rule after years of litigation could be abused. Second, the ability of an agency to moot a case at will could lead to enormous waste of judicial resources.

815 F.2d at 1452. The *Tallahassee* court further warned:

> While not intending to question the Secretary's good intentions, we cannot condone a regulation aimed specifically at on-going litigations, where the regulation has the effect of preventing the courts from awarding the full relief sought by the parties and already obtained by other hospitals in similar litigation such as *Lloyd Noland*. To permit such a regulation could effectively insulate the Secretary from review by giving him the power to short circuit a case after years of litigation and require the plaintiff parties to start the entire administrative and judicial review process all over again. As discussed above, the Secretary has acknowledged the possibility that, after a future challenge to the 1986 regulation had partially progressed through the courts, he could promulgate yet another regulation to defuse the challenge to the 1986 rule. Such a power could be used to abuse seriously the litigation process.

Tallahassee, 815 F.2d at 1456.

In *Mason General Hospital*, the court also recognized that granting the Secretary unlimited authority for retroactive correction would "result in the Secretary's ability to repromulgate successive corrective rules with retroactive

application to the date of the initial invalidated rule should subsequent attempts at rulemaking likewise be invalidated." 809 F.2d at 1225. Carried to its logical extreme, the Secretary could continue to promulgate "curative" rules, thereby effectively depriving the litigants of their rights.

The problems resulting from the agency's flouting of APA requirements cannot effectively be resolved through litigation, as the malpractice rule cases discussed above demonstrate. The Secretary had adopted a policy of "nonacquiescence" in final court decisions which reject his policies or reverse his actions. Several courts have noted this policy with disapproval. For example, in *Hillhouse v. Harris*, 715 F.2d 428 (8th Cir. 1983), the court stated:

> We note the Secretary continues to operate under the belief that she is not bound by district or circuit court decisions.

Id. at 430. *See also, id.* (McMillian, Circuit Judge, concurring specially) (possibility of contempt proceedings against the Secretary).

Similarly, in *Lopez v. Heckler*, 713 F.2d 1432 (9th Cir. 1983), Judge Pregerson stated:

> The Secretary's nonacquiescence [in our rulings] not only scoffs at the law of this circuit, but flouts some very important principles basic to our American system of government – the rule of law, the doctrine of separation of powers embedded in the constitution, and the tenet of judicial supremacy laid down in *Marbury v. Madison*, 5 U.S. (1 Cranch) 137, 2 L.Ed. 60 (1803). The government expects its citizens to abide by the law – no less is expected of those charged with the duty to faithfully administer the law.

713 F.2d at 1441 (Pregerson, J., concurring).

Again, in *Murray v. Heckler*, 722 F.2d 499 (9th Cir. 1983), the court began its opinion by observing, "[t]his case is one of many before this court as a result of the Secretary's refusal to follow this circuit's ruling in *Patti v. Schweiker*,

669 F.2d 582 (9th Cir. 1982), that disability benefits cannot be terminated without evidence of improvement." *Id.* 722 F.2d at 499. The court further stated: "We fault the Secretary not only for flouting the law of this circuit, but for failing to follow her own guidelines." *Id.* at 502.

Thus, even when the Secretary has been defeated repeatedly and resoundingly in litigation challenging his failure to comply with the procedural or substantive requirements of the APA, he continues to litigate cases which have virtually identical facts, forcing his opponents to expend substantial time and energy to vindicate their rights. *See, e.g., Stormont-Vail Regional Medical Center v. Bowen*, 645 F. Supp. 1182 (D.D.C. 1986).

Another closely related problem with the promulgation of retroactive rules is determining the scope of the permissible period of retroactivity: how far can retroactivity apply[12]

The *Tallahassee* court recognized that the Secretary's interpretation would permit him power to make retroactive changes "presumably back to the inception of the Medicare program in 1966." *Tallahassee*, 815 F.2d at 1453 n.36. As the Court in *Mason General Hospital* noted, this unlimited authority would

> [vest the Secretary] with the power not only to determine the appropriate change in the reimbursement formula, but the permissible period of retroactive application as well. Adoption of the construction urged by the Secretary would result in his ability to use unfettered discretion in enacting regulations

[12] Even under the Secretary's formulation, Brief for the Petitioner at 44 n.38, retroactive rules can be applied to any "open" cost reports. Because cost reports under appeal in litigation are" open," hospitals that have been litigating the malpractice rule issue since 1979 have nine successive "open" cost reports subject to retroactive application of any new rules the Secretary chooses to promulgate. This result is simply unacceptable on practical and equitable grounds.

> that give retroactive effect to any or every change that is made in the formulas for determining reimbursable costs.

809 F.2d at 1225. The court added that "it would fly in the face of settled principles of judicial review to permit an agency to be the sole determiner of the retroactive effect of its own pronouncements, particularly those governed by the safeguards of prospectivity embodied in the APA." *Id.* at 1226.

Finally, if the Secretary is allowed to "cure," retroactively, rules promulgated without proper notice and comment procedures, it is possible that flexibility in rulemaking will be lost. In *National Tour Brokers Ass'n. v. United States*, 591 F.2d 896 (D.C. Cir. 1978), the court observed that when proper prior notice and comment procedures are not followed, an agency might lose its "flexible and open-minded attitude towards its own rules . . . [because] the agency had already put its credibility on the line in the form of 'final' rules." *Id.* at 902. The court further noted that "[p]eople naturally tend to be more closed-minded and defensive once they have made a 'final' determination." *Id.* (footnote omitted).

The examples discussed above reflect a trend about which AHA and its member hospitals are justifiably concerned – the Secretary's seeming disregard for proper APA rulemaking procedures and the adverse consequences for beneficiaries and providers of services. In a similar case, the Court of Appeals for the District of Columbia Circuit held:

> We agree that "'the Commission's broad responsibilities . . . demand a generous construction of its statutory authority,'" but we do not believe the Commission should have authority to play fast and loose with its own regulations.

Panhandle Eastern Pipe Line Co. v. FERC, 613 F.2d 1120, 1135 (D.C. Cir. 1979) (footnotes omitted).

The difficult problems posed by "curative" retroactive rulemaking can be prevented. The best preventive measure against these potential abuses, and that adopted by Congress,

is to give force to the prohibition against legislative retroactive rulemaking embodied in the APA.

II. THE MEDICARE STATUTE DOES NOT PROVIDE AN EXCEPTION TO THE ADMINISTRATIVE PROCEDURE ACT'S BAN ON LEGISLATIVE RULES WITH RETROACTIVE EFFECT.

The APA makes clear that exceptions to its principles, such as the power to issue retroactive legislative rules, are not to be implied:

> No subsequent legislation shall be held to supersede or modify the provisions of this Act except to the extent that such legislation shall do so expressly.

APA § 12 (1946), *reprinted in Legislative History, supra*, at 9. The spirit of that provision is expressed in the analysis of the Senate bill provided to Congress by the Attorney General:

> [T]he act is intended to express general standards of wide applicability. It is believed that the courts should as a rule of construction interpret the act as applicable on a broad basis, *unless some subsequent act clearly provides to the contrary.*

Senate Report, Appendix to Attorney General's Statement Regarding Revised Committee Print of October 5, 1945, *supra, reprinted in Legislative History, supra*, at 231. (Emphasis supplied.) The Attorney General's views on section 12 were mirrored by the bill's sponsors in the hearings on the proposed legislation. *See Congressional Record Proceedings, supra, reprinted in Legislative History, supra*, at 371, 414.

On occasion, Congress has provided specific authority to apply legislative rules retroactively when it deemed such power appropriate. *See, e.g.*, 26 U.S.C. § 7805 (West 1976), which explicitly gives the Secretary of Treasury discretionary authority to apply rules retroactively. No such authority has been included in the Medicare statute.

The Secretary argued below, and maintains here, that 42 U.S.C. § 1395x(v)(1)(A)(ii) empowers him to issue legislative

rules with retroactive effect. Section 1395x(v)(1)(A) provides in relevant part:

> The reasonable cost of any services shall be . . . determined in accordance with regulations establishing the method or methods to be used, and the items to be included in determining [reasonable] costs.
>
> * * *
>
> *Such regulations shall . . . provide for the making of suitable retroactive corrective adjustments where, for a provider of services for any fiscal period*, the aggregate reimbursement produced by the methods of determining costs proves to be *either inadequate or excessive.*

42 U.S.C. § 1395x(v)(1)(A)(i),(ii) (West 1983) (emphasis supplied). The Secretary claims that the statutory language "admits" of his construction, and therefore it must be upheld by the Court. Brief for the Petitioner at 42.

As discussed, *supra*, however, the threshold question to be addressed is whether Congress has directly spoken to the issue. If the intent of Congress is clear, both the courts and the agency must give effect to that intent. *Young v. Community Nutrition Institute*, 476 U.S. 974, 980, (1986) (citing *Chevron*, 467 U.S. at 842-844 note-should be).

What the plain language of 42 U.S.C.§ 1395x(v)(1)(A)(ii) requires of the Secretary is that he provide, through legislative regulations, a *mechanism* for the individual, case-by-case consideration, *i.e.*, adjudication, of aggregate reimbursement produced by the methods formulated by the Secretary for the reimbursement of costs by the Medicare program.

The court in *Regents of University of California v. Heckler*, 771 F.2d 1182 (9th Cir. 1985), considered a hospital's demand for case-by-case adjustments and found that the "plain language" of section 1395x(v)(1)(A)(ii) required such adjustments. *Id.* at 1189-90. *Accord, St. Paul-Ramsey Medical Center v. Bowen*, 816 F.2d 417, 420 (8th Cir. 1987). *See also Medical Center Hospital*, 839 F.2d at 1511 (specifically

rejecting the Secretary's argument that "retroactive corrective adjustments" pursuant to section 1395x(v)(1)(A)(ii) are to be made on a "systemic," not individual, basis).

As the court in *Kingsbrook Jewish Medical Center v. Richardson*, 486 F.2d 663 (2d Cir. 1973), observed:

> Although we have uncovered no legislative history to elucidate this statutory language, its plain words do not require interpretative gymnastics. Where a"method of determining costs . . . produces an inaccurate reimbursement . . . Congress has instructed the Secretary to issue regulations providing for a "retroactive corrective adjustment."

Id. at 669. In *Kingsbrook*, the court clearly thought that regulations establishing a *process* for corrective adjustment were required.

The Secretary is unwilling to concede that the language of the statute plainly or unambiguously contradicts his position, and insists that his construction be upheld based on deference to his view of the most "sensible" approach to administration of the program.

Deference to an agency interpretation, however, is appropriate only when the agency is interpreting its own statute in a technical or complex area. The statutory construction issues before the Court do not require the application of the agency's health care expertise; rather, they are purely questions of law. *See Bowen v. American Hospital Association*, 476 U.S. at 642 n.30; *Bowen v. Michigan Academy of Family Physicians*, 476 U.S. 667, 670-73 (1986). More important, in this case, in determining what deference, if any, to afford, the courts also consider the consistency with which an agency interpretation has been applied, and whether the interpretation was contemporaneous with the enactment of the statute being construed. *NLRB v. United Food and Com'l Workers Union, Local 23*, ___U.S. at ___, 108 S.Ct. at 421 n.20; *INS v. Cardoza-Fonseca*, 480 U.S. ___, ___, and n.30, 107 S.Ct. 1207, 1221, n.30 (1987); *Bowen v. American Hospital Association*, 476 U.S. at 646, n.34 (fact that the agency interpretation has

been neither consistent nor longstanding substantially diminishes the deference to be given).

The conclusion that the interpretation of the scope and meaning of section 1395x(v)(1)(A)(ii) developed by the Secretary in this litigation is a new and opportunistic one is supported by a review of several prior inconsistent interpretations put forth by the Secretary since the enactment of the Medicare statute.

In *Kingsbrook*, the Secretary took the position that the "retroactive corrective adjustment" envisioned by section 1395x(v)(1)(A)(ii) is the end-of-year reconciliation of interim payments against the amount deemed due the provider, found in 20 C.F.R. 405.454 (1972) (*recodified at* 42 C.F.R. 413.64 (1987).[13] 486 F.2d at 669. The Secretary made the same argument eleven years later in *Regents of University of California*, 771 F.2d at 1189.

Yet, the Secretary *has* issued regulations which establish a case-by-case corrections process and which appear to implement the "retroactive corrective adjustment" authority.[14] Those regulations create the process of "reopening" reimbursement determinations. *See* 42 C.F.R. §

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[13] This view is supported to some extent by testimony made by the Commissioner of Social Security, Robert Ball, at hearings on the Medicare reimbursement regulations. This reconciliation process is independently authorized by 42 U.S.C. § 1395g, however. Thus, this interpretation would render the language of section 1395x(v)(1)(A)(ii) surplusage.

[14] The District Court in *Athens Community Hospital, Inc. v. Schweiker*, 514 F. Supp. 1336, 1338 n.5 (D.D.C. 1981), *rev'd on other grounds*, 686 F.2d 989 (D.C. Cir. 1982), surveyed the statutory and regulatory scheme and concluded that the reopening regulations are the *only* regulations addressing retroactive corrections. Moreover, this Court has apparently recognized the relationship between 42 U.S.C. § 1395x(v)(1)(A)(ii) and 42 C.F.R. § 405.1885. *Heckler v. Community Health Services of Crawford County, Inc.*, 467 U.S. 51, 54 (1984).

405.1885-1889 (1987). These regulations, which cite 42 U.S.C. § 1395x(v) as well as 42 U.S.C. §§ 1395hh and 1395oo as their statutory authority, *see* 39 Fed. Reg. 35414 (Sept. 26, 1974), reflect one of the Secretary's earliest interpretations of the scope of section 1395x(v)(1)(A)(ii). They establish a process to correct either underreimbursement *or* overreimbursement.

In fact, the Secretary has taken the position that the proper regulatory implementation of 42 U.S.C. § 1395x(v)(l)(A)(ii) is 42 C.F.R. 405.1885, the reopening regulation. At the Court of Appeals for the Seventh Circuit, the Secretary argued that he "was reasonable in construing 'retroactive corrective adjustment' to imply reopening," *i.e.*, the process set forth in 42 C.F.R. § 405.1885. Reply Brief for Appellant at 22-23, *St. James Hospital v. Heckler*, 760 F.2d 1460 (7th Cir. 1985) (No. 84-1478). The same connection between section 1395x(v)(1)(A)(ii) and 42 C.F.R. § 405.1885 was made by the Secretary in a brief filed with the Court of Appeals for the Tenth Circuit. Brief for Appellee at 46, *Humana of Aurora, Inc. v. Heckler*, 753 F.2d 1579 (10th Cir. 1985) (No. 83-2417).

Only recently has the Secretary argued that "retroactive corrective adjustments" pursuant to section 1395x(v)(1)(A)(ii) must be made on a systemic basis. *Medical Center Hospital*, 839 F.2d at 1511. Yet, the Secretary was "apparently unwilling to concede that he has *ever* interpreted the 'retroactive corrective adjustments' provision to require provider-specific adjustments." *Id.* at 1513 n.14. As that court noted, however, not only does the "plain language" of the statute require such adjustments, but such adjustments have been made available in the past on a provider-specific basis. *Id.*

The Secretary's varying interpretations appear to constitute "agency waffling without explanation," and should not be taken as authoritative. *Homemakers North Shore, Inc. v. Bowen*, 832 F.2d 408, 412 (7th Cir. 1987). Perhaps the only conclusion to be drawn from the confusion in this area is that it is, in large part, the Secretary's doing.

The conclusion that section 1395x(v)(1)(A)(ii) does not authorize retroactive changes in methods or principles of reimbursement, but simply requires an adjudicatory process, however, is consistent with the language of the statute and with the philosophy set forth in the testimony of Robert Ball, then the Commissioner of Social Security, who testified at hearings on the original Medicare reimbursement regulations that retroactive changes in reimbursement principles were not contemplated:

> *[W]e don't retroactively change the principles. . . .*
>
> * * *
>
> *I don't think that the retroactive provision contemplates going back over the year and changing the principles.* I think what is contemplated is that you pay first on the basis of advances, that is estimates not advances an estimate. . . . *It would hardly seem reasonable at the end of the year*, after hospitals had entered into an agreement with you on the basis of certain principles, *to shift all the principles for retroactive settlement in terms of how you compute a cost.* I don't think that was contemplated at all.

Reimbursement Guidelines For Medicare: Hearing before the Committee on Finance, United States Senate, 89th Cong., 2d Sess. (1966) at 56, 119. (Emphasis supplied.)

Commissioner Ball's testimony, while not determinative, is consistent both with the language of the statute and with the notions of equity and practicality that ought to be factors in the administration of the Medicare program

For these reasons, the Court should conclude that the Medicare statute does not authorize retroactive legislative rulemaking.

CONCLUSION

For the reasons set forth above, AHA respectfully submits that the decision of the court of appeals should be affirmed.

Respectfully submitted,

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June 27, 1988

(10)

No. 87-1097

IN THE

Supreme Court of the United States

OCTOBER TERM, 1988

OTIS R. BOWEN, SECRETARY OF HEALTH AND HUMAN SERVICES,
Petitioner,

v.

GEORGETOWN UNIVERSITY HOSPITAL, *et al.*,
Respondents.

On Writ of Certiorari to the United States Court of Appeals for the District of Columbia Circuit

MOTION FOR LEAVE TO FILE BRIEF AS *AMICUS CURIAE* AND BRIEF OF OHIO POWER COMPANY AS *AMICUS CURIAE* IN SUPPORT OF RESPONDENTS

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MOTION FOR LEAVE TO FILE BRIEF AS *AMICUS CURIAE*

Ohio Power Company hereby respectfully moves for leave to file the attached brief as *amicus curiae* in support of respondents in this case. Although the time for filing this brief has passed, the written consents of the attorneys for both the petitioner and the respondents have been obtained and are being filed with this motion.

The interest of the movant in this case arises from the fact that it is a party to a case in which the same issue has been raised, namely, whether the Administrative Procedure Act ("APA") prohibits an agency from promulgating retroactive rules upsetting past transactions between the government and a private party. On July 12, 1988, movant filed a petition for a writ of certiorari to the United States Court of Appeals for the District of

Columbia Circuit in which it asks this Court to consider that issue. *Ohio Power Co., et al. v. Thomas*, No. 88-60. Movant also has filed a motion asking this Court to defer consideration of that petition pending its decision in this case, because the resolution of the APA issue here may be dispositive of the *Ohio Power* petition. This Court's resolution of the APA issue therefore is of critical importance to the movant.

Movant's petition for certiorari in *Ohio Power* was filed less than thirty days ago, and movant has worked expeditiously since the filing of that petition to prepare its proposed *amicus* brief in this case. Moreover, movant has reviewed respondents' brief and the *amicus* briefs in support of respondents and believes that its proposed *amicus* brief would not be duplicative of these briefs, would provide a more detailed, historical analysis of the APA issue, and would demonstrate that this Court's resolution of that issue is important not only in the regulatory context of this case but also in other regulatory contexts.

More specifically, respondents' brief argues primarily as to construction of the Medicare statute and devotes relatively less time to the APA issue. The two *amicus* briefs that already have been filed focus more directly on the APA issue, but again in the context of the Medicare statute. Movant's brief, which is devoted exclusively to the APA issue, analyzes, among other things, the historical basis for the APA's proscription on retroactive rulemaking and the importance of the APA issue in another regulatory context. These arguments are not presented in any other brief. Therefore, consideration of movant's brief would be helpful to the Court in its review of this case.

Movant understands that this case has been set for oral argument on October 11, 1988. Because Petitioner's reply brief is not due until a week before argument, *see* Supreme Court Rule 35.3, Petitioner will have ample time to reply to movant's brief and will suffer no prejudice by the brief's late filing.

For these reasons, movant respectfully requests this Court to grant leave to file this brief as *amicus curiae*.

Respectfully submitted,

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QUESTION PRESENTED

Whether, absent an explicit statutory authorization to adopt retroactive rules that upset past transactions between the government and a private party, the Administrative Procedure Act precludes an agency from promulgating revised regulations that revoke rights conferred on a private party by the agency through an administrative determination completed in accordance with prior regulations?

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v.
GEORGETOWN UNIVERSITY HOSPITAL, *et al.*,
Respondents.

On Writ of Certiorari to the United States Court of Appeals for the District of Columbia Circuit

BRIEF OF OHIO POWER COMPANY AS *AMICUS CURIAE* IN SUPPORT OF RESPONDENTS

INTEREST OF THE *AMICUS CURIAE*

Ohio Power Company ("Ohio Power"), an operating subsidiary in the American Electric Power Company ("AEP") system, is the owner and operator of the Kammer Plant, a large electric generating facility located on the Ohio River in West Virginia. Ohio Power has filed a petition for a writ of certiorari to the United States Court of Appeals for the District of Columbia Circuit regarding a decision affecting its Kammer Plant.[1] That petition asks this Court to review one of the issues presented by this case—whether the Administrative Proce-

[1] *See* Ohio Power Co., *et al.* v. Thomas, No. 88-60 (petition for a writ of certiorari to the United States Court of Appeals for the District of Columbia Circuit filed July 12, 1988).

dure Act ("APA"), 5 U.S.C. § 551, *et seq.* (1982), permits an agency to promulgate revised regulations that revoke rights settled in an administrative proceeding conducted under prior regulations, where Congress has provided no specific statutory authority for rules to upset such past transactions between the agency and a private party.

The disposition of this case is critically important to *amicus*. Ohio Power spent over $500,000 in the course of a four-year proceeding with the United States Environmental Protection Agency ("EPA"), to obtain in 1982 EPA's final approval under § 123(c) of the Clean Air Act, 42 U.S.C. § 7423(c) (1982), of a stack height dispersion "credit" for the Kammer Plant.[2] Because § 123 nowhere authorizes EPA to revoke or reevaluate a dispersion credit once approved, Ohio Power relied on the finality of the administrative proceeding in which it obtained the credit.

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[2] Congress directed EPA in § 123 of the 1977 Clean Air Act Amendments to develop a program that would define the amount of dispersion "credit" to use in setting emission limits for individual sources pursuant to the National Ambient Air Quality Standards (NAAQS) established under § 109 of the Act. *See* Petition for Certiorari of Ohio Power Co., *et al.*, *supra* note 1, at 3-5. In § 123, Congress authorized the agency to adopt a general rule defining "good engineering practice" stack height dispersion credit that could be applied to sources that constructed stacks after 1970. Section 123(c) provides that EPA may allow credit greater than that allowed by this general rule in specific cases where "the source demonstrates, after notice and opportunity for public hearing, to the satisfaction of the Administrator, that a greater [stack] height is necessary" to avoid air quality problems.

Ohio Power obtained its stack height dispersion credit for the Kammer Plant under the § 123 rules then in effect, pursuant to the source-specific proceeding provided for in § 123(c). While any general stack height credit rule under § 123 may have a limited retroactive effect (i.e., § 123 applies to any stack constructed after 1970), § 123(c) nowhere provides, either explicitly or implicitly, for the revocation, expiration, or periodic reevaluation of credits approved by EPA after 1977 (when § 123(c) was enacted) in case-specific proceedings under that section.

Stack height dispersion credit, once determined for a source under § 123(c), serves as the basis for establishing that source's emission reduction obligations under the Clean Air Act.[3] Ohio Power therefore designed its air pollution control program and entered into long-term coal supply contracts and other engagements with third parties based on the emission reduction obligations determined by that credit.

Years later, in revising its § 123 regulations, EPA imposed new requirements for obtaining a dispersion credit and ruled that the effect of those revisions was to revoke the credit Ohio Power previously had obtained for the Kammer Plant. The Court of Appeals affirmed. *See Natural Resources Defense Council ("NRDC") v. Thomas*, 838 F.2d 1224, 1244 (D.C. Cir. 1988).

The outcome of this case therefore will have a direct impact on *amicus*. If this Court were to interpret the APA as allowing an agency, without an explicit statutory authorization, to adopt rules that revoke administrative determinations completed under prior rules, Ohio Power's settled expectations under § 123 derived from the past administrative transaction with EPA would be defeated.[4]

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[3] Of course, if the health and welfare-based National Ambient Air Quality Standards (NAAQS) established under § 109 of the Act are revised in a manner that makes them more stringent, the Act requires that the agency determine whether more stringent emission limitations are needed to implement that new standard. *See* Train v. Natural Resources Defense Council, 421 U.S. 60 (1975). Any such determination, however, must be based on the applicable § 123 dispersion credit determined by EPA. *See supra* note 2.

[4] The harsh impact of retroactive application of new regulations would extend beyond Ohio Power. For example, Ormet Corporation, a petitioner in Ohio Power Co. v. Thomas, No. 88-60, entered into aluminum supply contracts and other commitments based on the assumed availability of power from the Kammer Plant at a price that reflected the dispersion credit approved by EPA. Revocation of Ohio Power's existing stack height dispersion credit would endanger the continued existence of Ormet and the coal mine that currently supplies Kammer's needs. A more detailed discussion of

Given the close relationship of these cases, *amicus* has moved this Court to defer consideration of its petition for certiorari in *Ohio Power v. Thomas* until resolution of this case, and requests permission to file this brief in support of respondents in this case.[5]

SUMMARY OF ARGUMENT

Pursuant to the Constitution, Congress delegates power to administrative agencies to promulgate legislative rules executing the details of statutory pronouncements and regulating the affairs of private parties. The scope of an agency's power to determine the rights and duties of private parties depends on the breadth of authority granted in the statutory delegation. Where an agency has determined a party's rights pursuant to a statute that does not authorize the agency to reevaluate that determination, the party justifiably may expect that the agency may not revoke those previously determined rights by promulgating a revised rule.

Since earliest times, a central maxim of the common law has been that justice requires legislation to have prospective effect, except where the legislature expressly states its intention to the contrary. The Framers of the Constitution expressed a broad concern about the unfairness of retroactive legislation, and this principle found expression in the Constitution through several specific prohibitions on retroactive laws—the prohibition of *ex post facto* laws, bills of attainder, and laws impairing existing contractual obligations. In early cases construing these prohibitions, this Court made clear its distaste generally for statutes that "create[] a new obligation,

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the implications of revocation of the EPA-approved dispersion credit is contained in the petition for certiorari filed in Ohio Power Co. v. Thomas, *supra* note 1.

[5] Written consents to the filing of this brief have been obtained from the parties to this case, and have been filed with the clerk.

impose[] a new duty, or attach[] a new liability in respect to transactions or considerations already past."[6]

Congress, in adopting the APA, defined the legislative powers of federal agencies in a manner that was consistent with the historical notion that legislation should only operate prospectively. The APA specifically provides that a rule is "an agency statement of general or particular applicability and *future effect*." 5 U.S.C. § 551(4) (1982) (emphasis added). The legislative history is replete with discussion that confirms that a rule does not determine a party's rights or liabilities with respect to past conduct, but defines the future law so far as the agency is authorized to act. The common law and historical background, when combined with the language of the APA and its legislative history, leave no doubt that an agency given rulemaking powers in a statute cannot adopt rules that upset a past transaction between a private party and the agency, except where Congress has *explicitly* granted the agency the authority in the statute that the agency is administering to adopt such a rule.

ARGUMENT

Pursuant to the United States Constitution, Congress delegates power to administrative agencies to promulgate legislative rules executing the details of statutory pronouncements and regulating the affairs of private parties.[7] The power delegated to such agencies can be no broader than the power originally residing in Congress.[8]

Agencies today exercise this delegated power largely through promulgating legislative regulations that de-

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[6] Society for the Propagation of the Gospel v. Wheeler, 22 F. Cas. 756, 767 (C.C.D.N.H. 1814) (No. 13,156) (Opinion of Story, J.).

[7] *See, e.g.*, Opp Cotton Mills v. Administrator of the Wage and Hour Division of the Department of Labor, 312 U.S. 126 (1941); United States v. Grimaud, 220 U.S. 506 (1911).

[8] Lyng v. Payne, 476 U.S. 926, 937 (1986).

termine either directly, or through subsequent individual determinations, the rights and duties of private parties.[9] The scope of the statutory delegation to establish rules will affect private parties' reasonable expectations about the finality of their rights and obligations established under those rules. For example, where rights are established pursuant to a delegation that contemplates continuing agency review, private parties are on notice that rights established by an administrative determination are contingent on future rulemaking.[10]

By contrast, where a statute delegates to an agency the power to determine a party's rights but does not specifically authorize the agency to revoke those rights, an administrative determination creates settled expectations for the party whose rights have been determined.[11] Thus, an administrative determination that a party has complied with the statute as implemented through regulations then in effect, where Congress has not made that determination contingent upon subsequent regulatory developments, creates an expectation that the party has rights that may not be disturbed by subsequent admin-

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[9] K.C. Davis, *Administrative Law Treatise*, Vol. 1, § 1.9, at 34, § 6.1, at 448-49 (2d ed. 1978).

[10] Thus, where a permit is issued for a set period of time, or is subject to continuing reevaluation pursuant to an evolving regulatory standard (e.g., a "just and reasonable" standard), there can be no justifiable expectation that the rights established in that permit will remain forever unchanged. *See, e.g.*, Upjohn Co. v. FDA, 811 F.2d 1583 (D.C. Cir. 1987); American Airlines, Inc. v. CAB, 359 F.2d 624 (D.C. Cir.), *cert. denied*, 385 U.S. 843 (1966).

[11] *See, e.g.*, United States v. Seatrain Lines, Inc., 329 U.S. 424, 430-33 (1947); Hirschey v. FERC, 701 F.2d 215, 220 (D.C. Cir. 1983); Greater Boston Television Corp. v. FCC, 463 F.2d 268, 291 (D.C. Cir. 1971), *cert. denied*, 406 U.S. 950 (1972); Chapman v. El Paso Natural Gas Co., 204 F.2d 46, 53-54 (D.C. Cir. 1952); Utah International, Inc. v. Andrus, 488 F. Supp. 976, 984-87 (D. Colo. 1980); *cf.* American Methyl Corp. v. EPA, 749 F.2d 826, 834-40 (D.C. Cir. 1984).

istrative proceedings, either rulemaking or adjudication.[12]

In the case now before this Court, respondents successfully challenged in the Court of Appeals an attempt by the Department of Health and Human Services ("HHS") to change through rulemaking respondents' right to funds received under earlier rules. The effect of HHS's new rule would have been to require respondents to return to the government monies that had been properly paid to respondents under the prior regulations. The Court of Appeals confirmed that the benefits flowing to the respondents under the rules then in effect could not be revoked by newly revised rules. To impose new burdens on respondents with respect to the earlier transaction between the agency and respondents, the court reasoned, would be inconsistent with the APA definition of a "rule" as a statement of *future* effect, *see* 5 U.S.C. § 551(4) (1982), where the statute being implemented did not supersede the APA by explicitly authorizing such regulations.[13]

Amicus is seeking a writ of certiorari in a case (*Ohio Power v. Thomas*)[14] that also addresses whether an agency may use rulemaking proceedings to upset past administrative transactions that granted rights to private parties. The circumstances of that case bear many similarities to those of this case.

The statute involved in *Ohio Power* provides EPA with broad authority to act through rulemaking and through case-by-case informal adjudication, but does not provide for revocation of rights determined in administrative

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[12] *See also infra* note 57.

[13] Georgetown University Hospital v. Bowen, 821 F.2d 750, 757 (D.C. Cir. 1987).

[14] *See supra* note 1 and accompanying text.

proceedings conducted under earlier rules.[15] Moreover, like HHS in this case, EPA had exercised its statutory authority under prior regulations to define, "after notice and opportunity for a hearing," [16] the right of a private party to receive a benefit—in *Ohio Power*, a stack height dispersion credit to be used by the company in complying with Clean Air Act requirements at its Kammer Plant.[17]

As in this case, therefore, the previous regulatory transaction between the agency and the private party in *Ohio Power* established a right that the agency had no explicit statutory authority to take back.[18] Nevertheless, EPA, like HHS here, concluded that revision of the rules which had governed the earlier transaction justified revocation of the rights of the private party established in that transaction.[19]

Notwithstanding the similarities between these two cases, the Court of Appeals in *Ohio Power* refused to give effect to the APA proscription against retroactive rules, even though it found that EPA's new rules would have

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[15] *See supra* note 2.

[16] Clean Air Act § 123(c).

[17] As noted above, this credit has considerable monetary value to *amicus*. *See supra* pp. 2-3.

[18] *Amicus* does not dispute that if in the future it seeks additional stack height dispersion credit for the Kammer Plant, it will be required to satisfy all of the criteria contained in the most recent version of EPA's § 123 rules in order to qualify for that credit. Rather, *amicus* is concerned that the agency and the lower court have found that these new criteria, to the extent inconsistent with prior regulations, revoke any determinations made pursuant to those prior regulations. *See supra* pp. 2-3.

[19] Indeed, in *Ohio Power*, unlike this case, the new rules were found to revoke the prior transaction even though EPA did not specifically address in the rulemaking the status of rights granted under prior rules. NRDC v. Thomas, 838 F.2d at 1249.

retroactive effect.[20] The only explanation given by the Court of Appeals for not applying the general APA proscription was the assertion that this rule would not affect "past transactions" but only "future emissions." [21]

As discussed in Ohio Power's petition for certiorari, the assertion that there is no "past transaction" is simply wrong.[22] Moreover, the fact that "future" burdens will be imposed does not distinguish this rule from any other retroactive rule, since retroactive rules *always* impose only future burdens. Thus, revoking the Kammer dispersion credit will affect the plant's "future emissions," just as the repayment rule in this case will affect the hospitals' "future" cash flow. The critical element in both cases is not the future burdens imposed by the rule, since every rule (even a retroactive rule) imposes only "future" burdens, but the fact that both rules serve to upset past completed transactions between private parties and the government.[23]

Together, these cases raise important questions about an agency's authority to revoke, through legislative rulemaking, a private party's rights established in a previous administrative transaction under the then-applicable agency regulations. For the reasons discussed below, this Court should confirm that the APA precludes legislative rules that revoke rights established in prior regulatory transactions, where Congress has provided the agency with no explicit authorization to revoke such rights.

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[20] *Id.* at 1244. The court found that "[r]etroactivity is involved here" because the rule would affect "investments or other commitments [made] in reasonable reliance on prior understandings." *Id.*

[21] *Id.*

[22] *See* Petition for Certiorari of Ohio Power Co., *et al.*, *supra* note 1, at 13-14.

[23] *See also infra* note 49 and accompanying text.

I. The Common Law of This Nation Presumes That Legislation Has Prospective Effect.

Since earliest times, a central maxim of the common law has been that a new statement of the law affects the future, not the past.[24] As early commentators recognized, justice requires that laws be prescribed or promulgated with respect to future conduct, to avoid penalizing parties as a result of transactions that were legal when completed.[25]

American as well as English courts adopted this common law maxim as a rule of statutory construction. Courts therefore refused to give legislative acts retroactive effect unless their express language so provided.[26] Even then, retroactive laws were disfavored. As Chief Justice Kent explained, "[a] retroactive statute, affecting and changing vested rights, is very generally considered, in this country, as founded on unconstitutional principles, and consequently inoperative and void." [27]

An equally well-established strand of American jurisprudence, reflected in the Constitution, views the presumption against retroactive laws as an inherent limitation on the legislative power. Thus, the Constitution at several points provides that a new law may not revoke or burden transactions completed before the enactment of the law, specifically prohibiting the most flagrant historical examples of such abuses of legislative power—*ex*

[24] Coke, 2 Inst. 292 ("Nova constitutio futuris formam imponere debet, et non praeteritis"). *See generally* Smead, *The Rule Against Retroactive Legislation: A Basic Principle of Jurisprudence*, 20 Minn. L. Rev. 775 (1936).

[25] 1 W. Blackstone, Commentaries *46. *See also* Smead, *supra* note 24, at 777.

[26] *See, e.g.*, Dash v. Van Kleeck, 7 Johns. 477, 502 (N.Y. 1811) (opinion of Kent, C.J.) ("A statute ought never to receive such a construction, if it be susceptible of any other . . .").

[27] 1 Kent, Commentaries *455.

post facto laws, bills of attainder, and laws impairing existing contractual obligations.[28]

Beyond these specific prohibitions, the Framers also expressed a broader concern with retrospective legislation. For example, Madison in the *Federalist Papers* described such legislation as "contrary to the first principles of the social compact and to every principle of sound legislation." [29] To the Framers, the atmosphere of uncertainty and arbitrariness created by legislative interference with past transactions would frustrate their desire that government "inspire a general prudence and industry, and give a regular course to the business of society." [30]

Since the early days of this country, therefore, legislation that upsets previously established rights by imposing new burdens on the exercise of those rights has been disfavored. As Justice Paterson noted in *Calder v. Bull*, 3 U.S. (3 Dall.) 386 (1798), construing the *ex post facto* clause shortly after adoption of the Constitution:

> I had an ardent desire to have extended the provision in the Constitution to retrospective laws in general. There is neither policy nor safety in such laws; and, therefore, I have always had a strong aversion against them. It may, in general, be truly observed of retrospective laws of every description, that they neither accord with sound legislation, nor the fundamental principles of the social compact.[31]

[28] U.S. Const. art. I, § 9, cl. 3; *id.* § 10, cl. 1. *See also* Calder v. Bull, 3 U.S. (3 Dall.) 386, 389 (1798) (cataloguing extreme instances of abuse under English law); Cummings v. Missouri, 71 U.S. (4 Wall.) 277, 323 (1866) (same).

[29] *The Federalist* No. 44, at 282 (J. Madison) (C. Rossiter ed. 1961).

[30] *Id.* at 283.

[31] Calder v. Bull, *supra*, 3 U.S. (3 Dall.) at 397 (opinion of Paterson, J.). *See also id.* at 391 (opinion of Chase, J.) ("[I]t is a good general rule, that a law should have no retrospect. . . .").

While *Calder v. Bull* restricted the *ex post facto* clause to criminal cases, Justice Paterson's "ardent desire" found further voice in the early interpretations of the contracts clause, which the Court read expansively to accommodate its distaste for retroactive legislation. Thus, Chief Justice Marshall early expressed dissatisfaction with *Calder v. Bull*, noting that a civil law that revoked vested rights would operate with the same injustice as an *ex post facto* law.[32] Justice Story based his opposition to retrospective legislation "upon the principles of natural justice, upon the fundamental laws of every free government, upon the spirit and the letter of the constitution of the United States, and upon the decisions of most respectable judicial tribunals. . . ." [33]

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[32] Fletcher v. Peck, 10 U.S. (6 Cranch) 87, 138 (1810) ("Why, then, should violence be done to the natural meaning of words for the purpose of leaving to the legislature the power of seizing, for public use, the estate of an individual in the form of a law annulling the title by which he holds that estate? The court can perceive no sufficient grounds for making this distinction. This rescinding act would have the effect of an ex post facto law."). *See also* New Jersey v. Wilson, 11 U.S. (7 Cranch) 164 (1812) (Marshall, C.J.).

[33] Terrett v. Taylor, 13 U.S. (9 Cranch) 43, 52 (1815). *See also* Green v. Biddle, 21 U.S. (8 Wheat.) 1, 12 (1823).

By the time of Satterlee v. Matthewson, 27 U.S. (2 Pet.) 380 (1829), Justice Johnson, who earlier had called the rule against retroactive legislation "a principle which will impose laws even on the Deity," Fletcher v. Peck, *supra*, 10 U.S. (6 Cranch) at 143, was ready to reconsider Calder v. Bull and give the prohibition of retroactive civil legislation an explicit constitutional status. 27 U.S. (2 Pet.) at 414 (concurring in judgment only). *See also* his appended note, 27 U.S. (2 Pet.) 681 (1829). After reviewing the opinions in that case, he concluded that

> the learned judges could not then have foreseen the great variety of forms in which the violations of private right have since been presented to this court . . . . [T]he prohibition to pass laws violating the obligation of contracts is not a sufficient protection in private rights, and . . . the policy and reason of

Given the general distaste for retroactive legislation, this Court early on expressed its disfavor for "every statute which . . . *creates a new obligation, imposes a new duty, or attaches a new liability in respect to transactions or considerations already past.*" [34] Over time, the Court addressed a diverse set of transactions between the government and private parties in applying this general rule against retroactive legislation,[35] including transactions between private parties and the Executive Branch departments exercising delegated congressional power.[36]

Thus, well before the advent of the administrative state, the Court recognized in *United States v. MacDaniel* that "usages" not specifically described in a statute would of necessity evolve in departments of the federal government as a means of executing congressional statutes.[37] Reflecting the historical view that legislation has prospective effect, the Court held that "no change of such usages

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> the prohibition to pass ex post facto laws does extend to civil as well as criminal cases.

Id. at 685-86. With regard to the contracts clause cases, the Justice remarked that "[t]his court has had more than once to toil up hill in order to bring within the restriction . . . the most obvious cases to which the Constitution was intended to extend its protection. . . ." *Id.* at 686.

[34] Society for the Propagation of the Gospel v. Wheeler, 22 F. Cas. 756, 767 (C.C.D.N.H. 1814) (No. 13,156) (opinion of Story, J.) (emphasis added). *See also* Calder v. Bull, 3 U.S. (3 Dall.) at 391 (Chase, J.) ("Every law that . . . impairs . . . rights vested, agreeably to existing laws, is retrospective. . .").

[35] *See, e.g.*, State Bank v. Knoop, 57 U.S. (16 How.) 369 (1853) (bank charter); Dartmouth Coll. v. Woodward, 17 U.S. (4 Wheat.) 518 (1819) (college charter); Sturges v. Crowninshield, 17 U.S. (4 Wheat.) 122 (1819) (debtors' obligations); New Jersey v. Wilson, 11 U.S. (7 Cranch) 164 (1812) (tax exemption); Fletcher v. Peck, 10 U.S. (6 Cranch) 87 (1810) (legislative land grant).

[36] *See, e.g.*, United States v. MacDaniel, 32 U.S. (7 Pet.) 1, 14-15 (1833).

[37] *Id.*

can have a retrospective effect, but must be limited to the future. [*Past*] [*u*]*sage*[s] . . . *must be considered binding on past transactions.*" [38]

This historical distaste for retroactive legislation has been consistently echoed in the decisions of this Court. A century after *MacDaniel,* this Court reiterated that "legislation must be considered as addressed to the future, not to the past . . . [and] a retrospective operation will not be given to a statute which interferes with antecedent rights . . . unless such be the unequivocal and inflexible import of the terms, and the manifest intention of the legislature." [39] And shortly before enactment of the APA, the Court reaffirmed that this rule applies to the delegatees of congressional power as well as to the Congress itself.[40]

II. The APA Codified the Common Law Principle That Legislative Pronouncements Have Prospective Effect.

Transactions between private parties and the government burgeoned with the growth in the number and responsibilities of federal agencies during the first part of this century. Thus, the decade 1905-1915 "first saw the grant of substantial rule-making, rule-enforcement, and adjudicative powers to executive offices and independent

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[38] *Id.* The Court therefore prohibited the Secretary of the Navy from applying retroactively a new interpretation of a statute to vitiate a transaction completed under an earlier interpretation.

[39] Union Pac. R. Co. v. Laramie Stock Yards Co., 231 U.S. 190, 199 (1913). *See also* Greene v. United States, 376 U.S. 149, 160 (1964); Claridge Apartments Co. v. Commissioner, 323 U.S. 141, 164 (1944).

[40] Miller v. United States, 294 U.S. 435, 439 (1935) ("The law is well settled that generally a statute cannot be construed to operate retrospectively unless the legislative intention to that effect unequivocally appears . . . . An administrative regulation is subject to the rule equally with a statute; and accordingly, the regulation here involved must be taken to operate prospectively only.").

administrative agencies. . . ,"[41] and administrative agencies began increasingly to exercise their responsibilities through informal rulemaking.[42] Reflecting these developments, Elihu Root, then-President of the American Bar Association, observed in 1916 that "[i]f we are to continue a government of limited powers, these agencies of regulation must themselves be regulated . . . . *The rights of the citizen against them must be made plain.*" [43]

Against this background of concern with the fairness of the administrative process and with the scope of agency power,[44] Congress in 1941 began consideration of legislation to define the parameters within which agencies would exercise their delegated legislative and adjudicatory authorities. In 1946, Congress enacted the APA and described in it the nature of agency authority to prescribe "rules" governing the conduct of private parties.[45]

Consistent with the historical understanding that legislation applies prospectively, Congress defined a "rule" (the term used to describe agency-created legislation) as "an agency statement of general or particular applicability *and future effect.*" [46] Thus, the language "future effect" unambiguously categorizes agency-made legislation as "prospective" legislation, that is, legislation that operates on "future cases only" as opposed to "retrospective" legislation that "may also embrace transactions occurring before" its adoption.[47]

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[41] J.W. Hurst, *Law and Social Order in the United States* at 40 (1977), *quoted in* Davis, *supra* note 9, at 18-19.

[42] *See* Davis, *supra* note 9, at 18, 448-49.

[43] 41 A.B.A.R. 355, 368-369 (1916), *quoted in* Davis, *supra* note 9, at 19 (emphasis added).

[44] *See* Davis, *supra* note 9, at 20-21.

[45] *See* 5 U.S.C. § 551(4), § 553 (1982).

[46] 5 U.S.C. § 551(4) (1982) (emphasis added).

[47] Black's Law Dictionary 1075 (3d ed. 1933) (explaining that "[s]tatutes are . . either *prospective* or *retrospective*" (emphasis in original)).

Had Congress viewed the rulemaking function of federal agencies to include the inherent power to undo or burden past transactions, one would expect that it would have made that intent clear, given the historical distaste for retroactivity pervading our legal system and the general thrust of the APA to define the overall limitations on the exercise of agency power. Congress certainly would not have used the words "future effect" to describe agency created legislation that Congress contemplated would be applied retroactively.

The legislative history confirms this view. Thus, during the final House proceedings on consideration of S.7, Representative Walter explained each provision of the bill. In addressing the definition of "rule," he noted that "[i]n rule making an agency *is not telling someone what his rights or liabilities are for past conduct or present status* under existing law. Instead, . . . the agency is prescribing *what the future law shall be so far as it is authorized to act.*" [48] Similarly, the House Committee Report explains that "'[r]ules' formally prescribe a course of conduct *for the future* rather than pronounce past or existing rights or liabilities." [49]

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[48] Senate Committee on the Judiciary, 79th Cong., 2d Sess., *Administrative Procedure Act—Legislative History* ("APA Legislative History") at 355 (1946) (emphasis added).

[49] *Id.* at 254 (emphasis added). Petitioner argues that the "future effect" language, which was a late amendment to the bill, *see* APA Legislative History at 20, was added merely to clarify that a rule may take effect only after promulgation. *See* Petitioner's Brief at 30-33 (citing APA Legislative History at 423). The effective date provision in § 4(c) of the Act, however, is so specific that a clarification of this nature would have been unnecessary and hardly worth the special effort an amendment required. *See* 5 U.S.C. § 553(d) ("Publication or service of any substantive rule shall be made not less than 30 days before its effective date . . . ."). Rather, the phrase "future effect" only codified the common law understanding that a legislative pronouncement is presumed not to affect past transactions. Indeed, given the common law background and the general thrust of the APA, the effective date provision of § 4(c) itself is most logically read as an indication that Congress intended to adopt the historical principle that legislation has prospective effect.

This view is also confirmed by an authoritative, contemporary interpretation of the Act. Thus, the *Attorney General's Manual* discusses the definition of "rule" and "rulemaking" as follows:

> [Rules] must be of *future effect*, implementing or prescribing future law.
>
> * * * *
>
> *Rule making is agency action which regulates the future conduct* of either groups of persons or a single person; it is essentially legislative in nature, not only because *it operates in the future* but also because it is primarily concerned with policy considerations. *The object of the rule making proceeding is the implementation or prescription of law or policy for the future*, rather than the evaluation of a respondent's past conduct. . . .[50]

[50] United States Department of Justice, *Attorney General's Manual on the Administrative Procedure Act* at 13-15 (1947) (emphasis added). *See also* SEC v. Chenery Corp., 332 U.S. 194, 202 (1947) ("The function of filling in interstices of the Act should be performed, as much as possible, through this quasi-legislative promulgation of rules *to be applied in the future*" (emphasis added)).

Relying primarily on Addison v. Holly Hill Fruit Products, Inc., 322 U.S. 607 (1944), Petitioner contends that the common law before the APA's enactment did not disfavor the issuance of retroactive laws, and that the "future effect" language therefore should not be read to define "rules" as prospective legislation. *See* Petitioner's Brief at 22, 24. Petitioner's argument is contradicted by the very case he cites.

The Court in *Holly Hill* expressly confirmed the common law maxim that "law should avoid retroactivity as much as possible." 322 U.S. at 620. The dissenters (Justices Rutledge, Black, and Murphy) expressed the historical rule that legislation addresses the future in even stronger terms:

> The administrative process has increasingly important functions in our legal system. Ordinarily it does enough, if it takes care of today and tomorrow. When it begins to add yesterday,

In sum, the "future effect" language of the APA codifies the historical, common law understanding that legislation applies prospectively.

III. Common Law Principles and the APA Require That Statutory Grants of Rulemaking Authority Be Construed as Authorizing Only Prospective Regulation, Absent an Explicit Statutory Authorization To Adopt Legislative Rules Affecting Past Transactions.

Courts have traditionally viewed legislation as determining rights and responsibilities for the future.[51] Courts therefore adopted early on, as a principle of statutory construction, the presumption that legislation would have no retrospective effect unless plainly called for by Congress.[52]

Agencies may exercise only that authority delegated by Congress.[53] Since a law that Congress passes cannot be applied retroactively unless that is the unequivocal import of its terms and the manifest intention of Congress,[54] an agency may not adopt a legislative rule with retrospective effect unless specifically authorized to do so by Congress.[55]

Courts therefore have historically applied the presumption against retroactivity to include congressional dele-

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without clear congressional mandate, the burden may become too great. In any event, that has not heretofore generally been considered its task.

Id. at 641-642. Far from signalling acceptance of retroactive legislation, therefore, *Holly Hill* firmly endorsed the common law presumption against such legislation.

[51] *See supra* pp. 10-14.

[52] *See supra* notes 26, 39.

[53] *See supra* note 8.

[54] *Supra* note 38 and accompanying text.

[55] *See* Miller v. United States, 294 U.S. at 439.

gations of administrative authority. As several Justices observed in *Addison v. Holly Hill Fruit Products* shortly before enactment of the APA, retrospective regulation "has not heretofore generally been considered [the agency's] . . . task. If that task is to be added, the addition should be made from the body whence administrative power is derived. . . ." [56]

Accordingly, an agency cannot revoke rights previously granted to a party, where there is no statutory authority to revoke those rights. This result must follow regardless of whether those rights were established through rulemaking or adjudication.[57]

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[56] 322 U.S. at 641 (Justices Rutledge, Black, and Murphy, dissenting).

[57] Other *amici* in this case focus on the distinction the APA draws between adjudication and rulemaking, pointing out the "future effect" limitation on legislative rules, and the absence of such language for adjudications. *See* Brief of *Amicus Curiae* the American Hospital Ass'n at 7-13; Brief of *Amici Curiae* Sister of Mercy Health Corp. and Michigan Hospital Ass'n at 14-15. Given the common law distaste for upsetting past transactions, however, retroactivity is discouraged even in the context of adjudication.

Thus, where a person was a party to a prior adjudication (i.e., where he was a party to a completed transaction with the agency), rights established in that transaction may not later be revoked in a subsequent adjudication absent explicit statutory authority to do so. *See* United States v. Seatrain Lines, Inc., 329 U.S. 424, 430-33 (1947) (The Interstate Commerce Commission cannot revoke a certificate of public convenience and necessity previously issued to a water carrier, given the absence of explicit statutory authority.); American Methyl Corp. v. EPA, 749 F.2d 826, 834-40 (D.C. Cir. 1984); Hirschey v. FERC, 701 F.2d 215, 220 (D.C. Cir. 1983); Greater Boston Television Corp. v. FCC, 463 F.2d 268, 291 (D.C. Cir. 1971), *cert. denied*, 406 U.S. 950 (1972); Chapman v. El Paso Natural Gas Co., 204 F.2d 46, 53-54 (D.C. Cir. 1953). Even where a person who was *not* a party to a transaction with the agency relied on a legal principle established in another adjudication, that reliance, if justifiable, may not be upset absent an overriding statutory and public interest in retroactive application of that principle. *See, e.g.*,

The common law principle that agencies may not upset past transactions absent explicit statutory authority to do so has been codified as to legislative rulemaking by enactment of the APA.[58] The APA is "a measure . . . laying down definitions and stating limitations. These definitions and limitations must . . . [be] applied by agencies affected by them. . . ." [59]

Given the focus of the APA on defining the overall limits of agency authority, "the Administrative Procedure Act . . . must be read as part of every Congressional delegation of authority, unless specifically excepted." [60] In interpreting any grant of rulemaking authority in a statute subject to the APA, therefore, the APA construction of that authority as being prospective only must be given effect in the absence of an explicit congressional authorization to adopt retroactive rules that upset or otherwise affect past administrative transactions.

In the instant case (accepting here respondents' characterization of the Medicare statute), as in *Ohio Power*,[61] Congress has not explicitly provided for revocation or modification through rulemaking of rights previously es-

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Retail, Wholesale & Dep't Store Union v. NLRB, 466 F.2d 380, 390 (D.C. Cir. 1972).

In short, given the common law view that laws apply to the future, the authority of an agency to change retrospectively established rights does not depend upon the type of transaction in which the rights were established. Rather, if a person was a party to a transaction with the agency that established rights that the agency has no statutory authority to revoke, the proscription on retroactivity applies. By contrast, if a person merely relies on a legal principle that was never applied to him during a transaction with the agency, then retroactive application to him of a new principle will depend on a balancing of public and private interests.

[58] *See supra* pp. 14-18.

[59] APA Legislative History at 217 (Senate Report).

[60] Hotch v. United States, 212 F.2d 280, 283 (9th Cir. 1954).

[61] *See supra* note 2 and accompanying text.

tablished in transactions between private parties and the government. As a result, neither HHS nor EPA have authority to upset those rights through rulemaking.

CONCLUSION

For these reasons, this Court should affirm the decision of the Court of Appeals in this case and clarify that the APA proscribes retroactive rulemaking. Such a ruling will promote the just administration of law by federal agencies, in a manner consistent with long-established constitutional and common law principles.

Respectfully submitted,

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